House of Commons
Trade and Industry Committee

UK Automotive Industry in 2004

Eighth Report of Session 2003–04

Report, together with formal minutes, oral and written evidence

Ordered by The House of Commons to be printed 20 July 2004

HC 437
Published on 9 September 2004
by authority of the House of Commons
London: The Stationery Office Limited
£20.00

The Trade and Industry Committee

The Trade and Industry Committee is appointed by the House of Commons to examine the expenditure, administration, and policy of the Department of Trade and Industry.

Current membership

Mr Martin O'Neill MP (*Labour, Ochil*) (Chairman)
Mr Roger Berry MP (*Labour, Kingswood*)
Richard Burden MP (*Labour, Birmingham Northfield*)
Mr Michael Clapham MP (*Labour, Barnsley West and Penistone*)
Mr Jonathan Djanogly MP (*Conservative, Huntingdon*)
Mr Nigel Evans MP (*Conservative, Ribble Valley*)
Mr Lindsay Hoyle MP (*Labour, Chorley*)
Mr Andrew Lansley MP (*Conservative, Cambridgeshire South*)
Judy Mallaber MP (*Labour, Amber* Valley)
Linda Perham MP (*Labour, Ilford North*)
Sir Robert Smith MP (*Liberal Democrat, West Aberdeenshire and Kincardine*)

Powers

The committee is one of the departmental select committees, the powers of which are set out in House of Commons Standing Orders, principally in SO No 152. These are available on the Internet via www.parliament.uk.

Publications

The Reports and evidence of the Committee are published by The Stationery Office by Order of the House. All publications of the Committee (including press notices) are on the Internet at
http://www.parliament.uk/parliamentary_committees/trade_and_industry.cfm.

Committee staff

The current staff of the Committee are Elizabeth Flood (Clerk), David Lees (Second Clerk), Philip Larkin (Committee Specialist), Grahame Allen (Inquiry Manager), Clare Genis (Committee Assistant) and Sandra Thomas (Secretary).

Contacts

All correspondence should be addressed to the Clerks of the Trade and Industry Committee, House of Commons, 7 Millbank, London SW1P 3JA. The telephone number for general enquiries is 020 7219 5777; the Committee's email address is tradeindcom@parliament.uk.

Footnotes

In the footnotes of this Report, references to oral evidence are indicated by 'Q' followed by the question number. References to written evidence are indicated in the form 'APP' followed by the Appendix number.

Contents

Summary

The global automotive industry is dominated by a small number of very large vehicle producers who operate throughout the world. Competition is intense as established markets are nearing their limits for future growth, and as a result of significant global overcapacity. This competitive environment has led to pressure to constantly strive for innovation and efficiency in products and manufacturing.

Despite a number of high profile plant closures, the UK retains a successful automotive industry, with most of the largest vehicle and component manufacturers having some sort of presence here. The UK also has an established reputation for specialist engineering and design. The UK is home to some of the most productive vehicle manufacturing plants in Europe. However, this solid base may not secure all plants from closure: in the current climate, individual plant can be vulnerable to closure as companies restructure their production across Europe. Furthermore, the recent expansion of the EU has intensified the competition for future investment.

In order to stand the best chance of retaining as much automotive production as possible in the UK there are areas that need to be addressed. It seems that the UK is behind some of its competitors in the skills of its workforce, particularly amongst components producers. R&D is another area where the record of companies in the UK is not good enough. With the increasing technological sophistication of the industry, and the constant pressure to innovate and improve performance, both R&D and skills are vital and the UK cannot afford to lag in these areas. The industry also considers that the fact that the UK has not adopted the Euro has disadvantaged producers based here.

Despite changes to the block exemption agreement, we are not convinced that consumers in the UK are getting a good deal in purchasing new cars or in servicing. Retailers selling vehicles to individual consumers do not enjoy the same generous wholesale discounts as fleet purchasers, so their margins are tight with little scope to offer deals. Consumers are also paying too much for car repair and servicing, where competition is being constrained and minimum standards are lacking.

1 Introduction

The Global Automotive Industry

1. The automotive industry is characterised by ruthless competition in a market dominated by global conglomerates. The traditional car markets of the USA and Western Europe are now reaching their limits for expansion, so future sales growth in them is dependent on the manufacturers' ability to secure a greater share of the market for replacement vehicles than their competitors. This competitive pressure is compounded by the problem of excess global production capacity—in 2000 PricewaterhouseCoopers estimated that this was equal to 24 million units, or the equivalent of 96 modern assembly plants.[1]

2. Manufacturers have responded to this intensely competitive environment by constantly searching for ways to cut costs and increase efficiency: "If you look at every major vehicle manufacturer operating globally, in the course of the last two or three years each of them has announced and re-announced cost-reduction programmes".[2] This has also meant that they have required their suppliers to strive for efficiency and savings in a similar fashion as the competitive pressure is passed down the supply chain into the components industry.

3. Consolidation in car production is evident. An industry where a few giants dominate—more than 80% of world car production is accounted for by just six global groups[3]—is likely to concentrate further in coming years, with mergers between big vehicle producers "part of the new scenery".[4] This consolidation is also being seen in the components industry. PwC predicted that, by 2010, there would be only 20 or 30 major systems suppliers operating globally.[5] In addition to this, there are examples of collaboration between even the biggest firms; joint ventures are increasingly common as companies seek to spread the high cost of R&D.[6]

4. Whilst this pressure has resulted in a difficult climate for those involved in vehicle production, it has also had benefits. The intensely competitive nature of the industry and the constant drive for efficiency improvements has meant that the industry is at the forefront of development of new production techniques which are then adopted in other sectors. The search for a competitive edge is resulting in better value vehicles being produced. As Professor Rhys notes, this does not merely mean the efficient production of competitively priced, functional, but ultimately uninteresting products. Instead, innovative design is needed as well as efficient production in order to succeed in the current market: "competitiveness on the supply side of the equation is of little use, if unattractive and bland cars are the result. This is the lesson the Japanese are having to learn: quality of build and

1 PricewaterhouseCoopers, *The Second Automotive Century* (2000), p.11

2 Q 32 (SMMT)

3 Automotive Innovation & Growth Team ('AIGT'), *Executive Summary*, DTI (May 2002), p.13. The AIGT was an initiative that brought representatives from industry, government, academia, trade associations, unions and others with interests and expertise in the sector to identify ways of strengthening all aspect of the automotive production in the UK. It reported in May 2002.

4 PricewaterhouseCoopers, *The Second Automotive Century* (2000), p.14

5 *Ibid.*, p.15

6 Qq 116 (Toyota) and 295 (Ford)

outstanding production per man is of little consequence if the cars are poorly received”.[7] Moreover, recently, car prices in the UK have fallen to bring them more into line with the rest of Europe.[8] These factors have contributed to a thriving market for cars in the UK.

The UK Automotive Industry

5. Our predecessor Committee looked at vehicle manufacturing in the UK following the announcements that two of the largest automotive plants, GM’s factory at Luton and Ford’s at Dagenham, were to end vehicle production, and in the wake of BMW’s decision to dispose of Rover Group. It noted in its Report that “[i]t is over a quarter of a century since the UK vehicle industry faced a similar sense of crisis”[9] and that “[t]he UK vehicle manufacturing industry is seen by some as in the midst of a crisis which could lead to the meltdown of a significant part of the UK’s manufacturing base”.[10]

6. In spite of these fears, the UK retains significant automotive production and is home to some of the most efficient vehicle assembly plants in Europe.[11] 13 of the largest global vehicle producers have some form of manufacturing presence here, as do 17 of the world’s 20 leading ‘tier 1’ component suppliers.[12] There are also nine commercial vehicle plants, numerous internationally renowned design engineering firms, a significant motor sport industry, and a number of small, niche market vehicle producers.[13] Approximately 1.65 million vehicles were produced in the UK in 2003, about 3% of global production or 9% of European production. This ranks the UK ninth in the world and fourth in Europe in terms of vehicles produced.[14]

7. The automotive sector remains a significant contributor to the UK economy. According to the Government’s figures, vehicle production employs around 243,000 people in 3,200 businesses. It accounts for approximately £8.5 billion in value added, 1.1% of GDP, 6.2% of UK manufacturing value added, and 9.5% of total UK goods exports, making it the country’s largest manufactured export. Meanwhile, UK automotive sales for 2003 were at record levels for a third, successive year. Yet the industry has to work hard to maintain this position: margins are tight and there is constant pressure to innovate and make efficiency savings.

8. Given the continuing significance of the automotive sector to the UK economy, we decided to conduct an inquiry, covering both the prospects for vehicle production, and the current state of the automotive retail sector. To this end we took oral evidence from the Automotive Distributive Federation (ADF), the Retail Motor Industry Federation (RMI),

7 App 9 (Prof Rhys)

8 App 8 (RMI). Discussed further in Chapter 6.

9 Trade & Industry Committee, Third Report of Session 2000-01, *Vehicle Manufacturing in the UK*, HC 128, para 5

10 *Ibid.*, para 9

11 App 9 (Prof Rhys), table 2. ‘Efficiency’ is defined by vehicles produced per employee. It is a slightly crude measure as it does not take into account the relative complexity of different vehicle models but is useful for illustrative purposes.

12 The automotive supply chain is sub-divided into 3 tiers. Tier 1 comprises companies producing whole systems for direct supply to the vehicle manufacturers; tier 2 supplies components to the tier 1 companies; tier 3 comprises companies producing generic components or raw materials.

13 App 10 (SMMT), para 11

14 App 3 (DTI)

the Society of Motor Manufacturers and Traders (SMMT), the Transport and General Workers Union (TGWU), and Professor Garel Rhys of the Centre for Automotive Industry Research at Cardiff University Business School. We also wanted to hear directly from vehicle producers themselves, and so took oral evidence from Ford Motor Company, Phoenix Venture Holdings—the parent company of MG Rover—and Toyota. In addition we received a number of written submissions, which are listed on pages 37 and 38**.** Those directly cited are appended to this Report. We express our gratitude to all those who contributed to this inquiry.

2 UK Vehicle Production

9. Most of the largest vehicle manufacturing groups have some form of production facility in the UK. However, unlike a number of competitor countries such as France, Germany, Japan, or the USA, little of this production capacity is domestically owned. As a consequence of the absence of 'national champions', the automotive sector cannot depend on national sentiment to secure its future, but instead it must ensure it remains a competitive place to manufacture: "[it has] to persuade international capital that [it is] worth investing in".[15]

10. The difficulty is that even competitiveness and efficiency cannot guarantee the future of individual plant. With international conglomerates producing vehicles throughout the world, decisions on production are made on an international basis; and, given the consensus that countries such as China and India hold some of the greatest growth potential, we were concerned that the multinational car companies would move resources and production from the UK to Asia. We were assured that the cost of transporting finished vehicles, and the resulting preference of companies to build as close to their market as possible, is likely to prevent production from shifting on a vast scale to Asia.[16] However, our witnesses were less sanguine about the possibility of manufacturing moving elsewhere in Europe, and to Central and Eastern Europe in particular.[17] The UK is part of an integrated European car market—some 68% of the vehicles produced in the UK are exported, whilst 80% of the vehicles bought here are imports, predominantly from the Continent.[18] Consequently, decisions on the location for production of future models will be made on a Europe-wide basis. With domestic production so reliant on exports, and domestic sales so dominated by imports, the implications for the balance of payments could be serious.

11. The pressure on companies to introduce new models on a regular basis is considerable. In order to keep development costs to a minimum a platform is designed and a number of variations based around it are then produced. Even so, the production lifespan is limited and the turnover of new models and new platforms is rapid. With production organised on a Europe-wide basis, UK plants will be competing with their company's plants elsewhere in Europe to win new models to replace their existing ones as they reach the end of their production lifespan. This intra-company competition is all the more intensified as many companies have surplus productive capacity in Europe. Consequently, individual plant may be vulnerable in future as a result of company reorganisation and consolidation.

12. GM's decision to end vehicle production at its Vauxhall plant at Luton highlights this vulnerability. Luton was a profitable plant but was hit by the fall in sales of the Vectra it produced and a reduced production schedule for the Vectra's successor model, the Epsilon. This was compounded by the recent modernisation of Vauxhall's plant in Germany, which left Luton vulnerable when GM decided to reduce European capacity. As our predecessor

15 App 9 (Prof Rhys)

16 Qq 113 (Toyota) and 7–11 (SMMT)

17 See Chapter 5

18 App 3 (DTI)

Committee concluded, "Luton was the plant producing the wrong model at the wrong time. [Ending vehicle production] was the only way General Motors could take out a significant amount of capacity in the short-term".[19] The speed with which the decision was taken was noted in the Committee's Report,[20] and Professor Rhys emphasised that: "The real significance of the GM decision is not whether the UK is still a good place to make vehicles. Rather it is the speed with which the multinational took action to address an overcapacity problem which had dire implications for its European profitability… This has injected huge uncertainty into the equation, even if the UK remains a good home for vehicle making".[21]

13. In spite of the end of vehicle production at Luton and Dagenham, and the impact of BMW's withdrawal on Rover, UK total vehicle production is only a little lower than it was in 1997, with increases at other plants compensating for these closures. Professor Rhys remains optimistic that the UK record production figure of 1.92 million vehicles, set as long ago as 1972, can be exceeded in the near future.[22] Whilst the closures have grabbed headlines, he argues that they are primarily the result of company restructuring rather than a reflection of problems inherent in vehicle production in the UK. Consequently they should not be seen as symptomatic of the UK automotive industry as a whole.[23]

14. However, whilst individual plant closures have not fundamentally undermined the UK's vehicle production capacity, they can have a serious economic impact on the regions in which they are located. In areas such as the West Midlands, where vehicle production is long-established, the impact of closure can spread out through the supply chain to have an effect considerably beyond the plant itself. Future plant closures, even in the context of a reasonably strong automotive sector nationally, are clearly, therefore, a matter for concern.

15. Consequently, we were concerned by press reports that called into question the prospects for continued car production at Longbridge. The accusation in these reports was that Phoenix Venture Holdings (PVH), the consortium that had taken on Rover from BMW, had little interest in continuing vehicle production. Specifically, the suggestion was that, following PVH's reorganisation of the group, MG Rover—the loss-making car production company—had been isolated from the other, profitable parts. Press reports also referred to the fact that BMW had transferred significant former Rover assets to Techtronic, a holding company set up by the consortium that created the PVH group structure.[24] BMW also wrote off outstanding debts, reported to be of approximately £400 million, and provided a loan in the region of £500 million.[25] However, some press reports alleged that, following the creation of PVH, MG Rover was being starved of the investment

19 Trade & Industry Committee, Third Report of Session 2000-01, *Vehicle Manufacturing in the UK*, HC 128, para 53

20 *Ibid*, paras 48–49

21 App 9

22 *Ibid.*

23 *Ibid.*

24 Q 263 (PVH)

25 Ian Griffiths 'MG Rover gains scant benefit from BMW's £1bn largesse', *The Guardian*, 7 February 2004

that might ensure its long-term survival as available funds were, instead, being used to benefit the owners of PVH.[26]

16. Given its historic importance to the automotive industry of the UK and to the regional economy of the West Midlands, the future of MG Rover and the Longbridge plant is a highly emotive issue. This is compounded by the fact that it is the only British-owned volume car producer. Consequently, we questioned PVH's representatives on their plans for the company.

17. The reorganisation of the companies under PVH has clearly left MG Rover as a separate entity within the group. However, the other companies within the group are now also separate entities. Whilst, hypothetically, this could leave MG Rover isolated, it also reflects the structure of many large companies. It is a common management strategy designed, for instance, to better highlight the flows of capital around the group.[27]

18. Whilst it seems that the PVH directors have ensured they are generously remunerated for their involvement with MG Rover and associated companies, we found nothing to call into question their commitment to continued car production, both at Longbridge and elsewhere.[28] Despite restructuring of the company, funds continue to flow into MG Rover from the rest of the PVH group, rather than away from it.[29] Losses have been substantially reduced, from £378 million in 2000, when PVH took control, to £95 million in 2002, the most recent audited figures. Investment in engineering continues, including £100 million into a new medium-sized model,[30] and the company is in the process of negotiating several joint ventures and investing in plant abroad, for future production. **We were assured that this would not impact detrimentally on the prospects for future production at Longbridge. For example, Mr Towers assured us that production of the Rover 75 would continue at Longbridge, even if negotiations to acquire a plant in Poland are successful.[31]** Since we started our inquiry, PVH has successfully concluded negotiations with the Shanghai Automotive Industry Corporation (SAIC) to co-operate on new models.[32]

19. Vehicle production is highly competitive and the future for a company of MG Rover's size will be difficult in a market dominated by global conglomerates. This includes the continuous search for cost reductions in the supply of components. This and the expansion of MG Rover's international contacts will doubtless mean continuing challenges for those domestic suppliers diversifying to reduce their reliance on it. However, we found no evidence to suggest that its owners have any intention other than trying to compete as best they can. In doing so the challenges they face are the same as those faced by any other company making cars.

26 See, for instance, Ian Griffiths 'Rover's Financial Rebuild', *The Guardian*, 2 March 2004; Christopher Hope 'How Rover feathered its nest with Rover's prize assets', *The Telegraph*, 14 November 2003; Alex Brummer 'MG Rover drives into a storm over rewards', *The Daily Mail*, 17 December 2003

27 Qq 222 and 225

28 Q 195

29 Qq 225 and 264

30 Q 231

31 Qq 195-196

32 John Griffiths 'MG in tie-up with Chinese carmaker to fund new range', *Financial Times* (17 June 2004)

20. **The fact is, however, that both the history of MG Rover and its continuing role as the only UK-owned manufacturer mean that its affairs are likely to remain in the spotlight of public attention. In his evidence, Mr Towers acknowledged that the company has to take on board the unique position that it occupies in public debate. We are also conscious that the trade unions and others have condemned some of the allegations which have appeared in the press but are still concerned about some of the decisions that the PVH directors have made, including the scale of the benefits awarded. It is important that PVH finds ways of transparently promoting good governance, to dispel any doubts about the way in which its assets could be used in the future and to underline that sustainable car production at Longbridge remains its core focus. We therefore welcome Mr Towers' commitment to introduce a covenanting arrangement and/or appoint independent representation on the PVH board by the end of the year.**[33]

21. The commercial vehicles sector highlights the dangers of failing to remain competitive. Once one of the strongest commercial vehicle industries in the world, it seems that having lost this position, it has little chance of regaining it. With limited exports in this class, Professor Rhys describes it as 'an also-ran'.[34]

22. **The UK is still a competitive place to make vehicles, but, regardless of this, individual plants may still close. However, the risk of this will be reduced, and the prospects of continued investment in the remaining plant will be maximised, if constraints on competitiveness are identified and minimised. Whilst the UK is acknowledged to be a good venue for automotive production, our witnesses identified a number of areas of concern in the course of our inquiry.**

33 Q 274. After we agreed this Report, it was announced that an independent non-executive director, Mr Nigel Petrie, had been appointed to serve on the boards of both MG Rover and PVH. According to press reports, Mr Petrie has been given the option to recommend the recruitment of more independent directors as part of setting up audit and remuneration committees: 'MG Rover appoints first non-exec', *Financial Times* (22 July 2004), p23.

34 App 9

3 Skills

23. When we conducted our inquiry into UK competitiveness in manufacturing, skills shortages were highlighted as a constraint on manufacturing growth and on the adoption of more high tech working.[35] The automotive sector exemplifies this problem. The Automotive Innovation and Growth Team (AIGT) noted the importance of skills for the continued success of the UK automotive sector but concluded that "[t]his an area where the UK automotive sector continues to lag".[36]

24. Industry figures told us that this is a serious problem. Toyota complained of a continuing shortage of adequately skilled candidates for vacancies, which makes recruitment of staff and their subsequent retention difficult: "…shortages include engineering graduates and technician grade candidates. We also find that mathematics skills of applicants are particularly poor".[37] Whilst the company provides training in the specific areas needed it was worried about the general suitability for training, even amongst graduates: "We do not really mind what skills or knowledge they bring to the company because we will be training them anyway; but the basic English, the ability to communicate, the ability to interrelate with other people, and the basic mathematics have dropped off. That is clear".[38]

25. The need for continuing training is clearly recognised by the automotive manufacturers and they have various programmes to deliver this.[39] There have also been regional initiatives by Regional Development Agencies (RDAs) and Local Learning and Skills Councils (LSCs) aimed at improving the skills base for the automotive industry.[40] However, whilst the big, international companies invest in their own training, there is particular concern that this skills emphasis is not yet permeating the supply chain adequately.[41]

26. One of the AIGT's key recommendations was that an Automotive Academy should be established to provide training and boost skills throughout the sector. Since the 1990s, the SMMT Industry Forum has seen various automotive companies collaborating to develop and promote best practice in engineering. The AIGT proposals for the Automotive Academy took this collaboration to another level, encompassing skills development from the shop floor to senior management.[42] The Government accepted the AIGT's proposals for the Automotive Academy and it is currently in the process of being launched and its first students are registering. The Government has committed £15 million of funding with the rest coming from industry, though the aim is ultimately for it to be self-funding. Rather

35 Trade & Industry Committee, Third Report of Session 2001–02, *The Competitiveness and Productivity of UK Manufacturing Industry*, HC 597, paras 23–30

36 Automotive Innovation & Growth Team, *Executive Summary* (May 2002), p.5

37 App 12, para 4.4

38 Q 100; see also App 10 (SMMT), par 46 and App 14 (Vauxhall), para 2.5

39 Q 158 (Toyota)

40 Q 37. Though Toyota did say they had limited contact with LSCs: "We have had some discussion with them: not a great deal. I think they tend to leave us to our own" (Q 158).

41 The automotive supply chain is discussed in more detail in Chapter 4.

42 Automotive Innovation & Growth Team, *Executive Summary* (May 2002), pp. 6-7

than provide the training itself, the Academy, having reviewed skills needs and existing provision, will oversee the content and assessment of training provided regionally, through a ‘kitemark’ approval scheme.[43]

27. We also received evidence of the potential of motorsport for boosting education and skills in the automotive sector more broadly. Not only does the UK’s own motorsport industry require a continuous supply of highly skilled personnel to remain globally competitive, but the exciting image of motorsport can also be used to stimulate young people’s interest in engineering more generally. Ford representatives told us that this is the rationale behind the Jaguar Formula One in Schools competition. We are also pleased that the Government has recognised the importance of motorsport with the creation of the Motor Sports Strategy Board, and support for the Motor Sports Academy in particular.[44]

28. **We are pleased to see that the issue of skills is being taken seriously by both industry and Government. The Automotive Academy is an innovative solution to the problem in an industry where processes are increasingly high tech and innovation and adaptability are crucial and where persistent skills shortages could threaten the UK’s continued success. As well as the involvement and support from Government and unions, it is encouraging that, in an intensely competitive industry, the individual companies have been able to collaborate, as they have done in the Industry Forum, in establishing the Automotive Academy. With skills a problem throughout the industry and with a shared interest in improving the situation, collective effort would seem to have the best chance of success.**

29. The Automotive Academy is designed to enhance the skills of those already employed in the automotive sector. As such it can do little to improve the suitability of potential recruits to the industry. Whilst the evidence provided to us that potential recruits lack the required levels of numeracy and basic communication skills is anecdotal, it is naturally a concern. We are aware that the Government is trying to raise the standard of school leavers’ proficiency in basic skills; but we note that one of the competitive advantages attributed to a number of Eastern European countries is the comparatively high educational standard of their workforces. **Unless the UK is seen to have solved the basic skills problem rapidly, the comparative advantage enjoyed by our competitors may be a significant factor in decisions by companies on where to locate production.**

43 Q 63 (SMMT)

44 Q 302

4 The Supply Chain

30. The components sector is facing the same challenges as the vehicle manufacturers resulting from a highly competitive market, globalised production, and the constant pressure to improve productivity and to innovate. However, whilst large international companies are emerging at the top of the supply chain, the components sector still has a high proportion of Small and Medium-sized Enterprises (SMEs) who are unlikely to have the same resources to invest in remaining competitive.

31. Vehicle manufacturers have increasingly sought to reduce the number of suppliers with which they deal directly and to buy complete systems—suspension or transmission, for instance—which are then fed directly into their production process, rather than producing these themselves. In looking to purchase complete systems, the vehicle manufacturers are transferring much of the pressure they are under to innovate and make efficiency savings onto their suppliers, so the intense competition in the car market is being passed down the supply chain.

32. The rapidly evolving area of telematics—wireless communications technologies that are being integrated into vehicle control systems—will intensify the pressure on automotive suppliers to innovate. Existing systems are increasingly incorporating high technology electronics and telematics is also generating a growing number of new products to be included in vehicles such as Global Position Systems (GPS) and in-car entertainment.[45]

33. The pursuit of efficiency savings by the vehicle manufacturers is being passed on to the components sector, with two, potentially contradictory, trends emerging. First, the manufacturers are increasingly working with their suppliers to help reduce their costs. There are industry-wide examples of this such as the SMMT's Industry Forum and, now, the Automotive Academy. But individual companies are also working with their key suppliers to help them reduce their costs and improve efficiency. Mr Broome from the SMMT Industry Forum noted that "[i]t is encouraging to see the number of manufacturers who are embarking upon full supply chain development".[46] Toyota, for instance, mentioned the work they are doing with their Tier 1 and 2 suppliers and the use they are making of the Industry Forum.[47]

34. Secondly, there is a clear trend towards vehicle manufacturers, and tier 1 suppliers, sourcing their components internationally. Whilst vehicle manufacturers are continuing to work with their suppliers to increase efficiency, the quantity of components made in the UK that is going into the vehicles has fallen significantly and is continuing to do so. For instance, the UK-produced content of General Motors' UK-assembled cars is falling from 55% to 45% by value added; Honda are reducing theirs from around 70% to 50%; UK components comprise around 51% of UK-assembled Peugeots;[48] Toyota told us that they have reduced the UK-sourced components in their cars from 60% to 50%.[49] With the

45 Automotive Innovation & Growth Team, *Design, Development & Manufacture Report* (May 2002), p.6

46 Q 30 (SMMT)

47 Q 120. See also App 12, para 4.2 (Toyota)

48 App 9 (Prof Rhys)

49 Q 118

relentless pursuit of cost-savings, vehicle manufacturers are now prepared to source components from Europe and beyond. Whilst the cost of transport and a preference for Just in Time sourcing might lead manufacturers to prefer, where possible, to rely on local suppliers, if these advantages are substantially outweighed by cost savings then UK-based companies will lose out.[50]

35. Costs are not the only issue, though, and quality and innovation are also significant factors. The perception seems to be that efficiency is greater amongst continental firms.[51] This is clearly a concern: retaining as much automotive employment and value added as possible in the UK does not only depend on the continuation of vehicle assembly but on components as well: the components sector in the UK includes 2000 companies employing 140,000 people and with a combined turnover of £12 billion.[52] At the moment, however, it was suggested to us that too many companies in the UK components sector are too small. Consequently they lack the resources to invest in equipment, skills or research and development.[53] Consolidation is evidently required. The SMMT claim that there are signs that this is now taking place, with an observable decrease in the number of firms operating in the sector, but with no corresponding fall in employment.[54] However, it is clear that the components sector will continue to bear the brunt of the drive to cut costs in the automotive industry. The vehicle manufacturers are using their market power to pressurise suppliers into cost-reductions: we were told that they have been required to make annual price reductions of 5–10% annually over the last five to ten years.[55]

36. Dr Bryan Jackson of Toyota[56] told us that the quality of components in the UK and in Europe was sometimes lower than that available from their suppliers in Japan, stemming, primarily, from differences in the quality of R&D, which allowed the Japanese suppliers to make improvements to the components they were contracted to produce: "When I was in Japan dealing with Japanese suppliers, they had the drawing [of the component] but they would come up and say, 'We have looked at this. We can do this, this and this. It is the same performance. It is better quality. We can make it for a couple of yen less' and they would develop it. In the UK and in Europe it is very much 'Here is the drawing' and 'I have made it to the drawing'".[57]

37. Suppliers who can innovate to improve specifications of the components they are making or to lower the cost are clearly desirable for any vehicle manufacturer. However, this sort of relationship between supplier and vehicle manufacturer evolves over time. It requires a thorough understanding of the vehicle manufacturer's operations and requirements on the part of the components supplier, and it requires the vehicle manufacturer to have a very high degree of confidence in the expertise and judgement of

50 Exchange rate uncertainty has also had an impact on this process. This is discussed in Chapter 5.

51 Automotive Innovation & Growth Team, *Executive Summary* (May 2002), p.5 and *Design, Development & Manufacture Report* (May 2002), p.5

52 App 10 (SMMT), para 24

53 App 9 (Prof Rhys); Q 173 (PVH)

54 App 10, para 26

55 App 2 (Confederation of British Metalforming), para 4

56 Dr Jackson is Managing Director of Toyota Motor Manufacturing (UK)

57 Q 119

the supplier. As Toyota noted, this sort of relationship develops over a 20– or 30– year period of working together.[58]

38. The difficulty is that, in recent years, vehicle manufacturers have been less likely to maintain and nurture these types of relationship with their suppliers, as they increasingly source globally and aggressively use their market position to drive down the prices they pay for their components.

39. SMMT told us that the key to retaining, and indeed, promoting, a successful components industry in the UK is to focus on the high-tech, high value-added end of the spectrum.[59] Where the automotive manufacturers and large tier 1 suppliers have to invest significant amounts in product development, then they will look to longer term, more collaborative relationships with suppliers. On the other hand, suppliers of low value added products, where alternative suppliers are readily available, switching costs are low, and competition is almost exclusively price-based, will find it extremely difficult:[60] "there will always be someone cheaper than you".[61]

40. The implication of this is that, in a relatively high wage economy like the UK, components manufacturers must focus on investing in research and development and skills in the constant pursuit of innovation. However, the SMMT point out that levels of investment in R&D amongst UK components firms remains "worryingly low".[62] The high number of SMEs in the sector means that many do not have the knowledge to establish R&D programmes or to increase their skills base in the right way. Furthermore, the cost-cutting pressure from the vehicle manufacturers means that margins are tight and significant surpluses that can be reinvested in R&D are not being generated.

41. The production of engines is a good example of this. It is an area where the UK now has an established position.[63] Whilst individual plants may close, this is a sector in which the UK can establish itself as a world leader.[64] Not only are volume engine producers such as GM, Ford, Toyota, Honda, Nissan, and MG Rover all producing here, but the UK is also home to specialist engine builders such as Cosworth, and to several manufacturers of engines for commercial vehicles.[65] However, continued success is highly capital-intensive and engine performance is an area where there is considerable regulatory pressure to increase efficiency and lower emissions. Furthermore, it is a sector where new, cleaner fuel sources will have a disruptive effect on established technology in coming years. Investment in R&D is central to the UK's ability to maintain, and build on, its existing strength in engine production.

42. In addition to engine production, the UK has a significant number of other specialist firms in the spheres of performance engineering and motorsport. These range from low

58 *Ibid.*

59 Q 29

60 Q 30

61 Q 32

62 App 10, para 53 and Q 39 (SMMT)

63 App 10 (SMMT), paras 21-23; App 9 (Prof Rhys)

64 App 9 (Prof Rhys)

65 App 10 (SMMT), para 21

volume sports car manufacturers such as TVR and Lotus, to high performance engineering and other specialist firms in a cluster supporting the global motorsport industry from Formula One downwards. With a high proportion of spend on R&D, the UK's performance engineering is an important part of the automotive industry today with links to other high tech sectors such as aerospace. We have already referred to the relevance of motorsport to the education and skills agenda.[66] For these reasons we believe the motorsports and performance engineering sector is one which merits further study and to which we may wish to return.

43. The Automotive Distributive Federation (ADF) told us that the trends evident in the supply chain for car assembly were also present in the production of aftermarket components. With firms producing products for the aftermarket not tied into the vehicle production process, the sector is even more 'footloose'. There is overcapacity in the production of aftermarket parts and consolidation is underway. This has already seen plant closures and ADF implied that more would be likely: "from an aftermarket perspective, it is difficult to identify any real positive prospect for future growth in the UK production of [aftermarket] vehicle components".[67] The ADF noted the increasing volume of aftermarket parts being imported to the UK from countries such as Turkey, where labour costs are relatively low and skill levels increasing.

44. **The automotive components sector is a difficult market to operate in. There is considerable pressure from the vehicle manufacturers to both innovate and to reduce costs on a continuing basis. Margins are tight, yet investment is clearly required: our evidence suggests that those companies that do not focus on high value added products will find it hard to survive. Yet it is important that the UK retains, and, indeed, grows its automotive supply base. With vehicle manufacturers purchasing entire systems and passing an increased amount of the burden for R&D on to their suppliers, an increasing proportion of the value added of the car is accounted for by its components. This is a trend that is likely to continue with developments such as telematics. Consequently, it is vital that Government and industry representatives continue to collaborate to boost skills and investment in the sector.**

66 Para 27, above

67 App 1 (ADF)

5 Europe and the Euro

The Euro

45. The automotive industry in the UK is thoroughly integrated into a wider European market: domestic production is reliant on exports, primarily to mainland Europe, and the domestic market is served by imports, again, mostly from the Continent. Vehicle manufacturers are multi-national conglomerates who view Europe, rather than the UK, as the market and who make decisions on production accordingly. And, as noted in Chapter 4, UK vehicle production is itself increasingly reliant on components sourced from the Eurozone and beyond.[68]

46. With this European integration of the industry, it is of little surprise that exchange rates have been of constant concern for the industry; this would be the case even without the continued debate about Britain's adoption of the Euro. In a globalised industry reliant on imported components and exports of the finished product, changes in exchange rates can have a serious impact on costs and revenues.

47. When our predecessor Committee looked at this area in 2001, the high value of Sterling against the Euro was a particular matter of concern, as it was making British-produced vehicles exported to the Eurozone expensive. The relative rise in the value of the Euro in the intervening period has improved the situation, though Toyota said they would prefer it higher still—around €1.38 to the pound.[69] However, our witnesses emphasised that it was the uncertainty created by exchange rate fluctuation, rather than just the rate itself, that was problematic.[70] The desire for more stability underlies the industry's general support for UK Euro membership. However, our witnesses stressed that the rate of entry is significant, and should only be at a level that does not disadvantage the UK against the rest of the Eurozone.

48. Ms Sarah Chambers of the Department of Trade and Industry conceded that the UK vehicle manufacturers were disadvantaged by not being part of the Eurozone: "I think the stability argument is a very important one. Most of these companies are planning over very long timescales and being a very competitive industry it is a very small profit margin that most of them are working on, so fluctuations in currency are deeply significant to them".[71]

49. In the meantime vehicle manufacturers in the UK have taken various steps to reduce their vulnerability to exchange rate fluctuation. At least some of the competitive disadvantage deriving from exchange rates has been absorbed by the UK vehicle manufacturers' superior productivity.[72] This does, of course, mean that the UK is not gaining the full benefits of its greater efficiency in vehicle production. Furthermore, as noted in Chapter 4, whilst vehicle assembly is noted for its productivity, a large number of suppliers, particularly SMEs, are less efficient and will therefore feel the impact of

68 Automotive Innovation & Growth Team, *Executive Summary* (May 2002), p.4

69 App 12 (Toyota), para 2.3. At the time of writing, the rate is £1/€1.49

70 See for instance Q 19 (SMMT); Q 383 (Prof Rhys)

71 Q 420. Ms Chambers is Director of the Automotive Unit of the DTI.

72 Q 383 (Prof Rhys)

unfavourable exchange rates more heavily. Whilst the vehicle manufacturers are able to overcome at least some of the disadvantage from exchange rates, small component firms will be less able to do this.

50. A serious threat to the UK supply sector is caused by the practice of sourcing components from the Eurozone to protect against currency fluctuations. By replacing UK-manufactured components with components produced in countries that are members of the Euro, vehicle manufacturers can hedge against changes in the relative value of the two currencies.[73]

51. Some of the vehicle manufacturers have sought to offset their exposure to exchange rate changes by conducting business with their suppliers in Euros. A key plank in Toyota's 'survival plan' has been requiring its suppliers to invoice in Euros. Toyota rejected the suggestion that they were merely passing on their risk to their suppliers as they were not specifying the rate at which they quoted; it was up to the suppliers to choose the appropriate Sterling/Euro rate. However, given the extremely competitive nature of the supply sector, there will be pressure to quote as low a rate as possible, leaving little margin for changes in exchange rate. Consequently, it is probable that this policy does pass on the risk of exchange rate fluctuation to the supply chain.

52. **There can be little doubt that non-membership of the Euro has created difficulties for the UK automotive sector. Initially, the high value of Sterling against the Euro meant that UK exports were particularly expensive. With the value of the Euro having appreciated against Sterling in the intervening period, the rate of the two currencies is less of a concern now. Whilst the vehicle manufacturers would mostly prefer the value of the Euro to be higher still, the issue of predictability is of greater concern at the moment; exchange rate fluctuations can significantly reduce margins, which are already tight.**[74] **Whilst large vehicle manufacturers and tier 1 suppliers may be better equipped to cope with these fluctuations than smaller companies further down the supply chain, it is an issue for even the biggest manufacturers: marginal returns on small cars are themselves small and absolute profit is dependent on high sales. Where the margins are so tight, exchange rate fluctuations can have a serious impact on overall profitability.**[75]

53. The issue of Euro membership should not be held solely responsible for the difficulties of the components manufacturers. As Professor Rhys noted, "The problems facing the UK components sector are not all due to exchange rate issues, though they can intensify them. The basic efficiency of too many component companies is insufficient, the size of operations is too small, investment in all areas has been deficient and of course commercial advantage may mean buying abroad".[76]

54. Many UK vehicle manufacturers trade with areas that are not part of the Eurozone: many are heavily dependent on the US market, for instance. Moreover, there is no guarantee that the Euro will prove a more stable currency than Sterling. Nonetheless, the

73 App 9 (Prof Rhys)

74 Q 420 (DTI)

75 Q 387 (Prof Rhys)

76 App 9 (Prof Rhys)

Sterling/Euro exchange rate is one more variable that adds uncertainty. Furthermore, the industry's desire for Euro membership is primarily motivated by cost considerations rather than revenue: the manufacturers want to be able to predict production costs as accurately as possible. Consequently, even those manufacturers whose primary market was not the Eurozone believed that they could gain from Euro membership: "Frankly, if we could nail one of those [currencies] to do a five year business plan against that volatility it would be an advantage. Manufacturing margins are pretty slim and if you are making between 3 and 5% you are doing quite well. When you can get a 15 to 18% movement, as we have seen, in 50% of your revenue, it makes five year business plans a hopeless dream".[77]

EU Expansion

55. **The industry's preference for building close to market means that significant vehicle production is currently unlikely to shift from the UK to low cost economies such as India or China. Companies that have production facilities in the UK are increasingly involved in these markets, frequently through joint ventures with indigenous companies. But we were told that these are generally to gain access to markets that are anticipated to grow substantially in coming years. Vehicle production in these locations is not aimed at producing cars for export back into Europe and the UK.**[78]

56. There are of course exceptions to this. PVH has a deal with the Indian company, Tata, to produce the City Rover. This vehicle has been produced for European markets, but PVH told us that this would not affect their plans to continue production of other models in the UK at their Longbridge plant.[79] But with established markets reaching their limit for incremental growth, companies are looking to markets with greater potential.

57. A number of markets in Asia, notably China, are clearly attracting the interest of automotive manufacturers. But Eastern Europe is also an area where significant growth is predicted and a number of these countries have recently become members of the European Union. Given that they have well established industrial production and substantially lower wage levels than the UK, and that many manufacturers based in the UK already have production facilities there, we were concerned whether, as well as providing opportunities for vehicle sales, they now also provide a threat to continued UK vehicle production.

58. The SMMT presented the accession of new members to the EU primarily as an opportunity rather than a threat for the UK automotive sector. With the UK industry so dependent on exports to the EU, its enlargement means a larger market into which to sell. They did also acknowledge that "there is always a risk that industry can migrate to other markets, and it would be fatuous…not to underline that point".[80] However, they remained confident that the UK was a sufficiently competitive venue to maintain production in the face of the challenge from these economies: "Yes, there is a risk of migration, I do not

77 Q 283 (Ford)

78 Q 113 (Toyota); Qq 7–11 (SMMT)

79 Q 198

80 Q 17

belittle or deny it, but we do have a strong track record and I think it is strong enough to resist some of that migration”.[81]

59. Professor Rhys also thought that the risk of large scale relocation of automotive production from the UK to the accession countries was limited. He noted that the preparations for EU expansion had been in place for some time, so the automotive industry was already well integrated by the accession date.[82] Furthermore, he predicted that the wage advantage of these countries would swiftly be eliminated—already, manufacturers were looking further East, at countries like Belarus and Ukraine.[83] The Department agreed: “I do not think the impact of the accession…will be particularly revolutionary, I think we have already seen quite a lot of impact on us”. [84] However, there might be a threat resulting from a downturn which left companies with substantial excess capacity. If plants needed to be closed under these circumstances, companies might be reluctant to close their new, modern plant in Eastern Europe having invested so heavily in them.[85]

60. The vehicle manufacturers acknowledged that EU expansion entailed tougher competition but were mostly relatively confident that no mass migration of production was imminent.[86] Nonetheless UK plants had already lost work—Toyota UK had failed to secure the production of a new diesel engine, which would be made in Poland instead.[87]

61. **It seems that UK production is unlikely to migrate to the accession countries in the short term. Car companies work on an international basis and have been investing heavily in the accession countries for some time so there seems little prospect of an immediate ‘shock’ to UK vehicle production. However, the recent investment in production capacity in the new EU members will inevitably intensify competition between EU members for future investment in manufacturing and increase the competitive pressure on the UK.**

81 *Ibid*.

82 Q 400

83 Q 401

84 Q 465

85 Q 403

86 Qq 109–112 (Toyota), 192 (PVH), 285–287 (Ford)

87 Q 109

6 Vehicle Sales and Servicing

Sales

62. When our predecessor Committee looked at vehicle retailing, it was concerned that UK consumers were paying too much for their vehicles. Whilst there were mitigating factors, such as the UK tax system and the different specifications required for UK cars, the Committee concluded that the distribution arrangements were primarily responsible for consumers paying more for cars in the UK than in other EU countries.[88]

63. Since that Report was published, the trend in car prices in the UK has been downwards, which has brought them more closely into line with the rest of the EU; the Retail Motor Industry Federation (RMI) estimated falls in the region of 10%.[89] This is highlighted by the demise of the practice of parallel importing from other EU countries into the UK which was popular when the price differential was greater. Parallel importing gave rise to the paradoxical situation where UK-built cars which were exported to the EU, were then reimported to the UK. The RMI said that price reductions had seen the practice fall to negligible levels.[90]

64. The price reductions have seen UK car sales grow strongly. In 2003, 2.58 million cars were sold, a 0.6% rise on 2002, itself a record year. 2003 has been the third successive record year.

65. As well as the increased competition from the grey market of parallel imports, the RMI attributed the fall in prices to the impact of the Supply of New Cars Order 2000 and the revisions made to the block exemption rules. The Supply of New Cars Order limited the vehicle manufacturers' practice of pre-registering cars to give the impression of discounts, rather than publishing a lower list price. It also required the extension of fleet offers to the domestic consumer.[91] The block exemption rules were singled out in our predecessor Committee's Report as being "inherently anti-competitive" and unjustifiable.[92] The control over the sales network which the original block exemption rules allowed the vehicle manufacturers has been loosened by revisions that took effect in October 2003.

66. However, the RMI suggested that the vehicle manufacturers were still able largely to determine the retail price of their vehicles. Whilst not engaging in explicit price setting, the control that vehicle manufacturers retain over dealers' margins means that, in reality, they can still exercise considerable control over retail prices. The dealers have a margin of around 10% with which to deal and make a profit. In practice, they would normally retain only 2 or 3%.[93]

88 Trade & Industry Committee, First Report of 1998–99, *Vehicle Pricing*, HC 64

89 Q 322

90 Q 323

91 This is discussed in more detail in paras 67-68

92 Trade & Industry Committee, First Report of 1998-99, *Vehicle Pricing*, HC 64, para 38

93 Qq 329–333

67. RMI noted that fleet purchasers are able to buy vehicles at a very substantial discount. Given that fleet purchases are very large, it is unsurprising that generous discounts are available. However, it seems that these discounts are considerably in excess of those offered to even the largest dealers, despite the fact that these dealers may be placing even larger orders. In fact it was suggested that the vehicle manufacturers are seeking to recoup some of the value of the fleet discounts from sales to the domestic market—in other words, individual consumers are subsidising fleet purchases. [94]

68. **Car prices have fallen since this issue was last considered by our predecessor Committee. However, it seems clear that there is still scope for individual consumers to pay less for their cars. If the discounts offered to fleet purchasers were not as large, the margins with which dealers could trade with individual customers would not be as slim. We can see no reason why the discounts offered to fleet purchasers should be greater than those offered to any other bulk buyer such as a large retailer. The consolidation in the car retailing market was pointed out to us, though we were told that at the moment individual consumers could expect little benefit from this.[95] If bulk purchases by dealers were discounted in a similar way to fleet purchases of a similar size, consumers might see some benefit from this consolidation. At the moment that does not appear to be the case. Under these circumstances we would recommend that the Office of Fair Trading re-examine this area.**

Servicing

69. As well as retailing, the revision of the block exemption rules was supposed to improve competition in the servicing of cars by opening up the market beyond the franchised dealers. There are also requirements on the vehicle manufacturers to make information about parts available to improve competition in the provision of aftermarket spares. At the moment, the impact of the block exemption revisions seems to have been limited.

70. The cost of servicing cars in the UK remains higher than in either France or Germany. The Consumers' Association (CA) estimate that, once relative wages are taken into account, the UK is 50% more expensive than France, and 40% more expensive than Germany.[96] Neither is the quality of servicing particularly good: "Mechanics routinely miss out basic safety checks, charge for work they haven't done, and recommend unnecessary repairs".[97]

71. Whilst the block exemption revision was supposed to break the 'sales-and-service' link with franchised dealers, we were told that the effect had been limited. With tight margins in selling cars, franchised dealers have sought to recoup money through servicing. The Competition Commission suggested that their gross margins on sales of new cars were 4.6%, 21.1% on spare parts, and 60% on workshop hours. Inevitably franchised dealers are considerably more expensive than independent garages—the Office of Fair Trading (OFT)

94 App 8; Qq 334–339

95 Q 326 (RMI)

96 Consumers' Association, *Time for a Total Overhaul*: unpublished research paper

97 'Motorists Deserve Better', *Which?* (March 2004)

gives the average price as £199 and £116, respectively—but with no apparent difference in the quality of service received.[98]

72. Vehicle manufacturers can now give independent garages 'Authorised Repairer' status. However, the criteria that have to be met to achieve this status are so high as to seriously restrict the number of garages who are able or willing to achieve it. ADF suggested that it would require £30,000 of investment to meet Citroen's criteria for authorised repairer status.[99] Furthermore, criteria such as dedicated servicing areas for specific brands of vehicle, mean that achieving Authorised Repairer status will effectively restrict the number of different brands which a garage that has achieved the status can service. Some vehicle manufacturers have set lower criteria, presumably in order to encourage Authorised Repairers to fill gaps in their service network. **This would seem to indicate that the level of investment required by those that have set them higher is a barrier to entry, perhaps in order to compensate their franchised dealers, rather than a genuine requirement for being able to service their vehicle properly.**[100] **We fail to see, for instance, how specifying the type of carpet tiles required in the reception areas can be judged to impact on the quality of servicing and repair that a garage offers.**[101]

73. **It also seems that the market for aftermarket spares is being limited by the difficulty in accessing the technical specifications of the cars.** According to the RMI, information is available, but at a cost, and in an unstandardised manner. The levels of training required to understand the information varies considerably—even the name used for the same part varies between manufacturers.[102] This is significant as the independent garages generally rely on independent aftermarket products, rather than sourcing them from the vehicle manufacturer.[103]

74. **It seems that the aim of creating greater competition in the market for servicing and repairing cars is having limited impact.** Authorised repairer status has failed to provide independent competition to the franchised networks and prices are considerably higher here than in comparable countries. The Government and the trade associations have launched the CarWise scheme which pledges to give a better deal to consumers in the servicing of cars.

75. Standards of training of technicians are important and, as cars become increasingly technologically sophisticated, will become more so. We were therefore pleased to hear that the RMI is negotiating with the Institute of the Motor Industry to establish a technicians registration scheme, aimed at ensuring minimum standards of technical expertise.[104]

76. **The standards that, it is hoped, the CarWise scheme will introduce are to be welcomed. If it sets minimum standards for both the level of training that technicians have and for their conduct then it will be beneficial for consumers both in terms of**

98 Office of Fair Trading, 'Driving Competition in the Car After-Sales Market', Press Notice 59/04 (30 March 2004)

99 App 1

100 Q 356 (RMI)

101 Q 315 (RMI)

102 Q 356

103 Consumers' Association, *Time for a Total Overhaul*: unpublished research paper

104 Q 361

ensuring a minimum level of skills and promoting competition. However, this will not address the shortcomings with the Authorised Repairer status discussed above nor the need for franchised dealers to try to cross-subsidise their car sales from their servicing and repair work. The car market is clearly highly competitive and sales margins are tight. However, we see no reason why consumers should suffer restrictive practices in the servicing and repair of their cars. We believe that some of the conditions imposed on those wishing to become Authorised Repairers are anti-competitive, and we recommend that the Office of Fair Trading (OFT) investigate these practices.

7 Government Support

77. With the sector dominated by large multinational companies, Government's ability to give direct support to the industry is constrained by EU state aid rules. Nonetheless, the Government has been working with industry in a variety of ways. These are listed in the DTI's written submission.[105] We discuss some of the most significant initiatives here.

78. The AIGT was an innovative review of the automotive industry in the UK, its strengths and weaknesses, and the areas where Government intervention might help. The approach of bringing industry representatives, academic experts and other stakeholders together with Government to review strengths and weakness and identify areas to be addressed has evidently been considered a success by the DTI as IGTs have subsequently been launched in a number of other industries.

Research & Development

79. The AIGT identified several areas where Government action would help. We have already discussed the skills issue and how the Automotive Academy emerged from one of the AIGT's recommendations.[106] The AIGT also argued that Research and Development (R&D) was fundamental to the continued success of the UK automotive sector, but this again is an area where the UK has been considered to be underperforming.[107] The SMMT described the investment in R&D as "worryingly low".[108]

80. Since its introduction in 1997, the Foresight Programme has been the flagship vehicle for promoting innovation through commercialisation. It has provided matched Government funding to encourage collaboration between industry and academia. Since 1997 it has funded more than 100 projects, and also, in 1992, produced a 'roadmap' identifying key areas for future research. Foresight was criticised by the AIGT for funding too much blue skies research without clear application, for lacking focus, and for being inadequately commercially oriented.[109] In 2003 the SMMT took over the management of the programme from the National Engineering Laboratory. It is to be hoped that this will give it the commercial focus that it was considered to be lacking.

81. As well as the Automotive Academy, the Government has also adopted the AIGT's proposals for two Automotive Centres of Excellence. One of the Centres is focussing on low carbon and fuel cell technology, and the other on telematics and sustainable mobility. These Centres are intended to "identify gaps in existing knowledge and practice, establish integrated solutions, demonstrate how existing technology and knowledge can be industrialised, identify and bring in new players, and become leading knowledge transfer bodies for the automotive and supply base industries".[110] **With industry input, it is hoped**

105 App 3, paras 4.1–4.6

106 Chapter 3 above

107 Automotive Innovation & Growth Team, *Executive Summary* (May 2002), p.8

108 App 10, para 53

109 Automotive Innovation & Growth Team, *Technology Report* (May 2002), p.2

110 App 10 (SMMT), para 59

that the Centres of Excellence can successfully commercialise research in these key areas. We are, however, concerned at the apparent delays in establishing them. The announcement of their location is now overdue and the SMMT told us that, whilst progress was being made, "a kick up the backside" for those involved was required.[111]

82. One of the Centres of Excellence is devoted to new, cleaner fuel technologies, which highlights the emphasis being given to this area across the globe. It is clearly important that the UK establish itself at the forefront of the next generation of fuel technology and, with its strength in engine production, it should be in a good position to do so. One area of concern, however, is the balance that needs to be struck in research funding between a 'technology-neutral' approach and providing leadership to encourage research. Toyota told us that they were keen to see a technology-neutral approach to research on new fuel technology, with the onus being placed on standards rather than particular means to achieve them.[112] The danger with such a strategy, however, is that it allows uncertainty over which of the myriad new technologies will become successful. Under such circumstances, research in all technologies is jeopardised. In California, considerable investment is being put into the creation of a 'Hydrogen Highway' with a view to directing research and promoting the take-up of hydrogen cell technology. **It may be too early for the Government to back a specific technology but leadership may ultimately be required in order to stimulate the roll-out of the infrastructure required to make cleaner fuel cars commercially viable.**

83. **It is also important that research is not excessively concentrated on alternative fuels. The internal combustion engine will continue to be the means of powering the majority of cars for the foreseeable future. Considerable improvements have been made and will continue to be made in the environmental and economic efficiency of such engines—both petrol and, especially, diesel—so it is important that research in this area is not neglected by the UK. Again we were made aware of the potential of the UK's performance engineering and motorsports sectors in developing more environmentally efficient propulsion systems.**

Regulation

84. In the automotive industry, as in so many others that we have looked at, the issue of regulation has been a source of complaint. Whilst regulation *per se* is not necessarily dismissed as a bad thing, the complaint has been about the volume of new regulations emanating from the European Commission (EC). The managing director of Toyota UK told us: "If you take regulations individually, they are sensible and very much in line with our philosophy of how we operate—our ethics. The analogy I use is that it is like a brick: I can pick up a brick, examine it and say 'how am I going to use this?'; but when they come one after another it is a wall and now I have got to get over this wall. That is much more difficult".[113] Ford called for a better balance to be struck between environmental, social and economic aspects of regulation.[114]

111 Q 43

112 Q 123

113 Q 111

114 App 4, para 36

85. The countervailing argument is that, whilst regulations are frequently an irritant for those working in the industry, they have played a central role in driving improvements in engine efficiency that have reduced emissions, as well as in the area of safety for both passengers and pedestrians. There is little doubt that regulations do impose extra costs on vehicle manufacturers. However, we were not convinced that Ford's assertion that the cumulative per vehicle cost of EU regulations of $5000 is accurate, given the relatively low price of cars.[115] Furthermore, a number of regulations that were highlighted to us as problematic, such as the Working Time Directive or the Emissions Trading Scheme, are not peculiar to the automotive industry. Regarding emissions, there is a regulatory drive to lower emissions in both Europe and North America which will affect all manufacturers who produce or import into these markets. However, given the increasing concentration of UK production on larger, faster, or luxury cars such as Jaguars and Land Rover, the impact on UK manufacturing could be greater than elsewhere. **For environmental reasons, it is unlikely that the pace of such regulations will ease. Promoting investment in R&D to maximise opportunities for Britain to get the competitive advantage in producing the technologies to meet these challenges is therefore crucial. It is important that the Government plays an active role in supporting this and does not allow either national or European bureaucracy to inhibit such support being given.**

86. What seems to be causing as much anguish as the number of EC regulations is their interpretation and implementation in the UK. The suspicion amongst those operating in the UK is that EC regulations are interpreted overly strictly, 'gold-plated', or introduced earlier than in other member countries. With these other countries making greater use of any scope for interpretation, UK-based operations are, it is claimed, put at a disadvantage.[116] It was acknowledged that much of the evidence for this was anecdotal, though the Emissions Trading Scheme was one example that was mentioned.[117] This is obviously a concern as, if true, then companies operating in the UK are being placed at a disadvantage. We have also been presented with anecdotal evidence that EC regulations on government procurement policies are interpreted rather more inflexibly in the UK than in some places, to the detriment of firms manufacturing vehicles in the UK.[118] **All Government departments and agencies should examine their own methods to satisfy themselves that they are not operating procurement rules too inflexibly and that they take full account of the importance of their own role in promoting and safeguarding the UK manufacturing base.**

87. Preventing new regulations from Europe is not within the competence of this or any other individual Government. The Department has sought to help industry cope with new regulations via its VIPER[119] programme, which aims to provide an 'early warning system' by monitoring and anticipating the thrust of new regulations before they emerge.[120] However, the Department is responsible for the manner in which regulations are

115 App 4, para 36. PwC estimated the global average per unit cost of vehicle production to be $4,311: PricewaterhouseCoopers *The Second Automotive Century* (2000), p.11

116 App 10 (SMMT), paras 40–42

117 Qq 112 and 121 (Toyota)

118 Qq 77–80 (TGWU)

119 Vehicle Industry Policy and European Regulation

120 App 3, para 4.4 and Qq 413–417 (DTI)

implemented. **UK-based firms should not be disadvantaged by the way in which regulations are interpreted and implemented. A central plank of the Government's policy on Europe should be to ensure the consistent implementation of regulations throughout member countries. In this context, we note the recent statements by Ministers of their intention to scrutinise the National Allocation Plans of other Member States in relation to the European Union Emissions Trading Scheme and to raise any doubts about insufficiently rigorous proposals in such plans with the European Commission. We also urge any company with evidence that other Member States are not playing by the rules on regulation to bring this evidence formally to the attention of the Commission—otherwise there will be no action to rectify the situation.**

Conclusions and recommendations

UK Vehicle Production

1. The UK is still a competitive place to make vehicles, but, regardless of this, individual plants may still close. However, the risk of this will be reduced, and the prospects of continued investment in the remaining plant will be maximised, if constraints on competitiveness are identified and minimised. Whilst the UK is acknowledged to be a good venue for automotive production, our witnesses identified a number of areas of concern in the course of our inquiry. (Paragraph 22)

Migration of Production

2. The industry's preference for building close to market means that significant vehicle production is currently unlikely to shift from the UK to low-cost economies such as India or China. Companies that have production facilities in the UK are increasingly involved in these markets, frequently through joint ventures with indigenous companies. But we were told that these are generally to gain access to markets that are anticipated to grow substantially in coming years. Vehicle production in these locations is not aimed at producing cars for export back into Europe and the UK. (Paragraph 55)

3. It seems that UK production is unlikely to migrate to the EU accession countries in the short term. Car companies work on an international basis and have been investing heavily in the accession countries for some time so there seems little prospect of an immediate 'shock' to UK vehicle production. However, there will inevitably be more intensification of competition between EU members, old and new, for future investment in manufacturing and this will increase the competitive pressure on the UK. (Paragraph 61)

Components Sector

4. The automotive components sector is a difficult market to operate in. There is considerable pressure from the vehicle manufacturers to both innovate and to reduce costs on a continuing basis. Margins are tight, yet investment is clearly required: our evidence suggests that those companies that do not focus on high value added products will find it hard to survive. Yet it is important that the UK retains, and, indeed, grows its automotive supply base. With vehicle manufacturers purchasing entire systems and passing an increased amount of the burden for R&D on to their suppliers, an increasing proportion of the value added of the car is accounted for by its components. This is a trend that is likely to continue with developments such as telematics. Consequently, it is vital that Government and industry representatives continue to collaborate to boost skills and investment in the sector. (Paragraph 44)

Skills

5. Unless the UK is seen to have solved the basic skills problem rapidly, the comparative advantage enjoyed by our competitors may be a significant factor in decisions by companies on where to locate production. (Paragraph 29)

6. We are pleased to see that the issue of skills is being taken seriously by both industry and Government. The Automotive Academy is an innovative solution to the problem in an industry where processes are increasingly high-tech and innovation and adaptability are crucial and where persistent skills shortages could threaten the UK's continued success. As well as the involvement and support from Government and unions, it is encouraging that, in an intensely competitive industry, the individual companies have been able to collaborate, as they have done in the Industry Forum, in establishing the Automotive Academy. With skills a problem throughout the industry and with a shared interest in improving the situation, collective effort would seem to have the best chance of success. (Paragraph 28)

Regulation

7. UK-based firms should not be disadvantaged by the way in which regulations are interpreted and implemented. A central plank of the Government's policy on Europe should be to ensure the consistent implementation of regulations throughout member countries. In this context, we note the recent statements by Ministers of their intention to scrutinise the National Allocation Plans of other Member States in relation to the European Union Emissions Trading Scheme and to raise any doubts about insufficiently rigorous proposals in such plans with the European Commission. We also urge any company with evidence that other Member States are not playing by the rules on regulation to bring this evidence formally to the attention of the Commission—otherwise there will be no action to rectify the situation. (Paragraph 87)

8. For environmental reasons, it is unlikely that the pace of regulations affecting the automotive industry will ease. Promoting investment in R&D to maximise opportunities for Britain to get the competitive advantage in producing the technologies to meet these challenges is therefore crucial. It is important that the Government plays an active role in supporting this and does not allow either national or European bureaucracy to inhibit such support being given. (Paragraph 85)

R&D

9. Research and Development is fundamental to the continued success of the UK automotive sector, but we heard concerns that the UK is falling behind its competitors. With industry input, it is hoped that the Centres of Excellence can successfully commercialise research in the key areas of low carbon and fuel cell technology and telematics and sustainable mobility. We are, however, concerned at the apparent delays in establishing the centres. The announcement of their location is now overdue and the SMMT told us that, whilst progress was being made, "a kick up the backside" for those involved was required. (Paragraph 81)

10. It may be too early for the Government to back a specific cleaner fuel technology but leadership may ultimately be required in order to stimulate the roll-out of the infrastructure required to make cleaner fuel cars commercially viable. (Paragraph 82)

11. It is also important that research is not excessively concentrated on alternative fuels. The internal combustion engine will continue to be the means of powering the majority of cars for the foreseeable future. Considerable improvements have been made and will continue to be made in the environmental and economic efficiency of such engines—both petrol and, especially, diesel—so it is important that research in this area is not neglected by the UK. Again we were made aware of the potential of the UK's performance engineering and motorsports sectors in developing more environmentally efficient propulsion systems. (Paragraph 83)

The Euro

12. There can be little doubt that non-membership of the Euro has created difficulties for the UK automotive sector. Initially, the high value of Sterling against the Euro meant that UK exports were particularly expensive. With the value of the Euro having appreciated against Sterling in the intervening period, the rate of the two currencies is less of a concern now. Whilst the vehicle manufacturers would mostly prefer the value of the Euro to be higher still, the issue of predictability is of greater concern at the moment; exchange rate fluctuations can significantly reduce margins, which are already tight. Whilst large vehicle manufacturers and tier 1 suppliers may be better equipped to cope with these fluctuations than smaller companies further down the supply chain, it is an issue for even the biggest manufacturers. (Paragraph 52)

Government procurement

13. All Government departments and agencies should examine their own methods to satisfy themselves that they are not operating procurement rules too inflexibly and that they take full account of the importance of their own role in promoting and safeguarding the UK manufacturing base. (Paragraph 86)

MG Rover

14. We were assured that MG Rover's proposed joint ventures and its investment in plant abroad would not impact detrimentally on the prospects for future production at Longbridge. For example, Mr Towers assured us that production of the Rover 75 would continue at Longbridge, even if negotiations to acquire a plant in Poland are successful. (Paragraph 18)

15. Some press reports have suggested that PVH has little interest in continuing production at Longbridge and that MG Rover is being starved of funds to the benefit of the owners of PVH. We found no evidence to suggest that its owners have any intention other than trying to compete as best they can. The fact is, however, that both the history of MG Rover and its continuing role as the only UK-owned manufacturer mean that its affairs are likely to remain in the spotlight of public attention. We are also conscious that the trade unions and others have expressed concerns about some of the decisions that the PVH directors have made, including the scale of the benefits awarded. It is important that PVH finds ways of transparently promoting good governance, to dispel any doubts about the way in which its assets could be used in the future and to underline that sustainable car production at Longbridge remains its core focus. We therefore welcome Mr Towers' commitment to introduce a covenanting arrangement and/or appoint independent representation on the PVH board by the end of the year. (Paragraphs 15, 18, 19 and 20)

Car prices and the Consumer

16. Car prices have fallen since this issue was last considered by our predecessor Committee. However, it seems clear that there is still scope for individual consumers to pay less for their cars. If the discounts offered to fleet purchasers were not as large, the margins with which dealers could trade with individual customers would not be as slim. We can see no reason why the discounts offered to fleet purchasers should be greater than those offered to any other bulk buyer such as a large retailer. There has been consolidation in the car retailing market. If bulk purchases by dealers were discounted in a similar way to fleet purchases of a similar size, consumers might benefit from this consolidation. At the moment that does not appear to be the case. Under these circumstances we would recommend that the Office of Fair Trading re-examine this area. (Paragraph 68)

Servicing and Repair

17. It seems that the aim of creating greater competition in the market for servicing and repairing cars is having limited impact. Vehicle manufacturers can now give independent garages 'Authorised Repairer' Status. However, the criteria set by the manufacturers to achieve this status vary widely, with some manufacturers effectively requiring investment of tens of thousands of pounds. Others have set significantly easier criteria. This would seem to indicate that the level of investment required by those that have set them higher is a barrier to entry rather than a genuine requirement for being able to service their vehicle properly. We fail to see, for instance, how specifying the type of carpet tiles required in the reception areas can have any impact on the quality of servicing and repair that a garage offers. (Paragraphs 72 and 74)

18. It also seems that the market for aftermarket spares is being limited by the difficulty in accessing the technical specifications of the cars. (Paragraph 73)

19. The CarWise scheme is to be welcomed. If it sets standards for both the level of training that technicians have and for their conduct then it will be beneficial for consumers both in terms of ensuring a minimum level of skills and promoting competition. However, this will not address the shortcomings with the Authorised Repairer status discussed above nor the need for franchised dealers to try to cross-subsidise their car sales from their servicing and repair work. (Paragraph 76)

20. The car market is clearly highly competitive and sales margins are tight. However, we see no reason why consumers should suffer restrictive practices in the servicing and repair of their cars. We believe that some of the conditions imposed on those wishing to become Authorised Repairers are anti-competitive, and we recommend that the Office of Fair Trading (OFT) investigate these practices. (Paragraph 76)

Formal Minutes

Tuesday 20 July 2004

Members present:

Mr Martin O'Neill, in the Chair

Mr Roger Berry	Mr Lindsay Hoyle
Mr Richard Burden	Ms Judy Mallaber
Mr Michael Clapham	Linda Perham
Mr Nigel Evans	Sir Robert Smith

The Committee deliberated.

Draft Report (UK Automotive Industry in 2004), proposed by the Chairman, brought up and read.

Ordered, That the Chairman's draft Report be read a second time, paragraph by paragraph.

Paragraphs 1 to 87 read and agreed to.

Summary read and agreed to.

Resolved, That the Report be the Eighth Report of the Committee to the House.

Ordered, That the Chairman do make the Report to the House.

Ordered, That the provisions of Standing Order No. 134 (Select Committees (reports) be applied to the Report.

Several papers were ordered to be appended to the Minutes of Evidence.

Ordered, That the Appendices to the Minutes of Evidence taken before the Committee be reported to the House.—(*The Chairman.*)

[Adjourned till Tuesday 7 September at half past Three o'clock.

Witnesses

Tuesday 9 March 2004

Mr Christopher Macgowan, Mr Paul Everitt and Mr Graham Broome, **Society of Motor Manufacturers and Traders Ltd**	Ev 1
Mr Steve Hart, **Transport and General Workers Union**	Ev 14

Tuesday 30 March 2004

Dr Bryan Jackson OBE, Mr Paul Philpott and Mr Mike Hawes, **Toyota**	Ev 21
Mr John Towers and Mr Peter Beale, **Phoenix Venture Holdings (MG Rover)**	Ev 30
Mr Roger Puttnam and Mr Joe Greenwell, **Ford Motor Company**	Ev 42
Mr Brian Spratt, **Automotive Distributive Federation**	Ev 48

Tuesday 4 May 2004

Mr Matthew Carrington and Mr Alan Pulham**, Retail Motor Industry Federation (RMI)**	Ev 51
Professor Garel Rhys, **Centre for Automotive Industry Research, Cardiff University Business School**	Ev 58
Ms Sarah Chambers, Mr Ashley Roberts, Mr Francis Evans and Mr Phillip Davies, **Department of Trade and Industry**	Ev 67

List of Written Evidence

List of Unprinted Written Evidence

Engineering and Physical Sciences Research Council
Group Lotus plc
Johnson Matthey Fuel Cells
Motorsport Industry Association
Transport and General Workers Union

Oral evidence

Taken before the Trade and Industry Committee

on Tuesday 9 March 2004

Members present:

Mr Martin O'Neill, in the Chair

Mr Roger Berry	Mr Lindsay Hoyle
Richard Burden	Judy Mallaber
Mr Michael Clapham	Linda Perham
Mr Jonathan Djanogly	Sir Robert Smith

Witnesses: **Mr Christopher Macgowan,** Chief Executive, **Mr Paul Everitt,** Head of Communications, Economics and Policy, and **Mr Graham Broome,** Chief Executive, Industry Forum, the Society of Motor Manufacturers and Traders Limited, examined.

Q1 Chairman: Good afternoon, Mr Macgowan. Can I welcome you here once again. It is some years since you were here last, but that, as much as anything, was the reason why we decided to return to the subject. Because sometimes committees like ours are accused of ambulance-chasing, if that is the appropriate expression. Certainly, we are going in, looking at it and just leaving the issue. We felt that there had been a number of changes over the last two or three years and that it would be useful to discuss with you and your colleagues and interested stakeholders what the state of play was. We are mindful of the time on the last occasion we started—I think we were going to look at Longbridge, and following the potential closure of Longbridge—then we had the closure of Dagenham and thereafter the announcement of the closure of Luton. We hope our inquiry will not have that effect on this occasion, but that was more accidental than anything else. One of the problems which remain with us is overcapacity. I realise that, to an extent, it is not quite as big a problem as it was, in the UK, but it is still a global problem. Given the global nature of the car industry, do you think that the UK's automotive industry is likely to shrink much further? What is the mood, if you can tell us, please?
Mr Macgowan: I think the mood is that we have been through our most difficult years and things definitely seem to be stabilising. You are right to reflect on some of those closures, which you mentioned in your opening remarks, but of course it is worth noting that we are now back up to a production level of about 1.65 million vehicles a year in the UK. I think the view is that we have stabilised at that level and we are starting to build up again. Yes, we have been through a difficult time. As regards overcapacity specifically, volumes in the UK are increasing again, and really it just goes to prove that you need to be able to demonstrate that the UK is indeed a good place to be building vehicles, that we are competitive and that we can fight our way in the world. I think that is what has happened since the last time I appeared before your Committee. Also, of course, it is worth saying that, in actual fact, Luton is far from being closed, Dagenham is far from being closed and all sorts of good things have been going on in the meantime, but, you are right, they were headline "closures".

Q2 Chairman: I think the point was that at that time they were being closed for the purposes of car assembly, and perhaps the point you were making was that the car assembly business in the UK is still quite robust and resilient. I think that the supply chains which feed them, and in which I suppose you have an interest as well, I am never quite sure to what extent you have more than, as it were, informal links with that part of the industry. Maybe you could put your part of the car industry in context with the supply chain and see whether the restoration of assembly numbers would be along the same lines as the supply chain?
Mr Macgowan: We have an absolute commitment to the entire manufacturing process. Indeed, I have with me my colleague, Graham Broome, who is the Chief Executive of SMMT Industry Forum, who is involved specifically in some of those supply chain issues. If you do not mind, I will ask him to make a contribution.
Mr Broome: To add to Christopher's point, we are heartened by the volumes which we are seeing being manufactured in the UK, and naturally it gives an added advantage where we have got close proximity so we have got some logistical benefits for the supply chain. I think we have seen some very, very impressive steps up in the productivity and competitiveness performance at all levels of the supply chain, so we are in a lot healthier condition—but certainly not complacent—compared with the last time that Christopher came before this Committee.
Chairman: Thank you.

Q3 Mr Hoyle: What you are saying is that 1.65 million cars are being produced in the UK, that is fantastic, but is that complete cars or is that where we tinker a bit with the headlights, or swap the boot, or something? What are we talking about, is it complete or badging with cars? I am never quite sure, and I am sure the Committee would sooner know where it stands.

Mr Macgowan: Let me be very clear to you. It is 1.65 million vehicles, so it is cars and light commercial vehicles and heavy commercial vehicles, to be very precise.

Q4 Mr Hoyle: It is everything?

Mr Macgowan: Yes, but the overwhelming percentage, in fact, is cars, and those are cars which are assembled, built, here in the United Kingdom. They do not refer to the kind of exercise that you are talking about, where a bit of last-minute tinkering is done and then the vehicle is sold on, that is not what we are talking about. We are talking about real, genuine production, we are talking about the vehicles which are built at Nissan, in Sunderland, Toyota, Honda, fully-fledged production. It is very interesting to me, because I have been in the industry for many a long year, but if you were to go back in time, to the so-called halcyon days of the industry, back in the sixties, I think we were building about 1.6/1.7 million complete cars then. Okay, there were some other vehicles as well but, frankly speaking, we are back to those kinds of volumes, whereas many people would make the observation that, in some way, we have sort of shrunk dramatically from those days. We are back almost to those sorts of levels.

Q5 Mr Hoyle: As you include wagons, vans and everything, what is the difference between, say, the last time we had these conversations, three years ago, and now, in pure car production?

Mr Macgowan: The figures have been just gently inching forward since we were last together. The car production figure, I would have to come back to you on a specific car figure, but the overall vehicle production is there at 1.65, and I guess about three years ago probably it was 1.45–1.5.

Q6 Mr Hoyle: Was that all-car or all-vehicle?

Mr Macgowan: Paul may have some statistics which will help.

Mr Everitt: Actually, in 1999, which perhaps was just before some of the difficulties which hit the industry, we produced 1.7 million cars, solely cars, which was about the highest level since the very early 1970s. Obviously, because of the closures at Dagenham and Luton, we drifted down in 2000–01 to around 1.45 million cars and since then we have moved up to about 1.65 million cars in 2003. Our forecasts on car production are around the same level and drifting up, again, to about the 1.7 million level.

Q7 Linda Perham: With the main expanding markets seeming to be places like China and India, are companies likely to move nearer to those areas so that they are closer to the new markets?

Mr Macgowan: You are absolutely right that, of course, those are what you might call the glamour markets, at the present moment, the markets which are showing huge growth. As far as we are concerned, those markets will be supplied by their domestic suppliers, absolutely that is the case. Our best opportunity in those markets really is through our component manufacturing business, the opportunity to set up businesses in both China and India and to provide vehicles from the UK which are suited to those markets, but, fundamentally, those markets will be supplied locally, by local manufacturers. Our opportunity is in the areas of things like technology transfer, there is some of that going on already, and at the SMMT we are involved in introducing UK companies to Chinese companies and forming joint ventures and making certain that we are involved in that way as well. There are opportunities in those markets, it is absolutely the case.

Q8 Linda Perham: I am sorry, I am not quite sure what you mean by domestic suppliers. I am talking about the possibility of setting up large plants for the main manufacturers in those countries?

Mr Macgowan: Again, I will ask Paul to throw some light on that.

Mr Everitt: Essentially, what we are seeing is that these are growth markets, the level of demand for new vehicles in those markets has been very small and is now growing. A number of the global vehicle manufacturers are looking to take advantage of that growth by setting up plants in those markets. The demand will be met predominantly from plants which are established in those markets. It is unlikely to take production from perhaps the UK and transplant it into somewhere like India or China, certainly not at this particular time anyway. It is much more likely that there are opportunities, as those markets liberalise and as their economies grow, that there is potential for UK and European-based vehicles to be sold into those markets.

Q9 Linda Perham: In fact, contrary to what we were saying, and the Chairman's first question was about the automotive sector being bound to shrink, actually you see possibilities, and China and India have got huge populations, there is a real chance that the industry could expand globally?

Mr Macgowan: Yes, that is absolutely right, but it will not be expansion in the conventional way. I put it to you, it will be expansion through technology transfer, it will be expansion by introducing companies which are in the UK to partners in China, and there have been some famous examples already where this is starting to take place. I think that is where the opportunities for UK industry really stem from, because we do have this unrivalled reputation in the UK for our technical ability, our ability to handle projects around the world. I think that is what we are good at and we are seeing evidence of some of that coming to fruition.

Q10 Chairman: We kind of missed the boat with China, insofar as, at the moment, in China, you look around and if you are going to get run over by anything it is going to be a VW rather than a bicycle, at some time?

Mr Macgowan: Absolutely, that is right, and I would not wish, in any way, to describe to the Committee a situation anything other than the fact that those manufacturers who have been there for many years—and you mentioned Volkswagen, which is a very good example, certainly they have the advantage of that vision and being there first. All the time in the background there are companies like GKN, like Pilkington, who have been operating with Chinese partners for many a long year, and that is where our area of expertise lies.

Q11 Mr Djanogly: If I can stay on that one, briefly, Chairman. We know, from various surveys, that almost all manufacturers are looking at the relative costs of manufacturing in the Far East, and you did not go quite so far as to say why cars should not be manufactured in the Far East. Is it the costs of transporting them here?
Mr Macgowan: The plain truth is that we operate in a global industry, as you know only too well, and there is a strong argument for building reasonably close to market. Therefore, it is becoming less likely that vehicles are being transported enormously long distances and people are tending to build closer to market, which is why, for instance, Volkswagen have a plant in China, as do many others. That is the way the industry is going and I think that will be the way we will see it progressing for the next few years.

Q12 Mr Djanogly: Looking a bit closer to home, what impact do you think the expansion of the European Union eastwards will have on the domestic market?
Mr Macgowan: I think it is the most wonderful opportunity, because we have got these additional Member States joining us from May onwards and this means that, essentially, we will have a much bigger domestic market than we had the day before. This is a fantastic opportunity for us and I think it is perceived as very, very good news.

Q13 Mr Djanogly: We are only a few months away from it happening. Do you think the industry has prepared itself for those opportunities?
Mr Macgowan: Yes, I think so. I have been visiting the countries which are about to accede to the European Union to see what kind of condition they are in, in terms of some of the regulations that we have, and they all want to get very, very heavily involved immediately, and our colleagues here in the UK likewise. I think that the timetable is well understood and there is a great opportunity for expansion, yes.

Q14 Mr Djanogly: Which is, what, building cars out there?
Mr Macgowan: In some instances, it is a question of doing better in some of those markets with those vehicles that we build here in the UK, but again it is the formation of joint ventures with manufacturing businesses in those countries as well, so it is a two-pronged attack.

Q15 Mr Djanogly: Is that happening?
Mr Macgowan: It is starting to happen, yes.

Q16 Mr Djanogly: Can you give any examples?
Mr Macgowan: For instance, the other day, our colleagues from the Korean Hyundai struck up a deal with one of those acceding members, and we are involved very closely with the supply of components to that factory. It is there, it is happening and it is good news.

Q17 Sir Robert Smith: Can I just clarify though, in terms of the growing challenge, when you assemble finally near to the market, is Eastern Europe near enough to the UK market to mean that assembly could shift from here to Eastern Europe, if the economics dictated that?
Mr Macgowan: I think that the UK has established itself over a number of years as being a very, very good place to manufacture product and I think that needs to be said time and time again. I always take every opportunity I can to remind the Government of the day that this is an industry that we should cherish and nurture, and, those manufacturers that we have here, we should be looking after their interests and making certain that it is as successful as it possibly can be. Of course, there is always the risk that industry can migrate to other markets, and it would be fatuous for me not to underline that point, and indeed I want to underline that point to illustrate the fact that we need to nurture that which we have got. Mercifully, our current investors are extremely happy, by and large, with what they find here in the UK. It is no accident that, for instance, just to name a couple of examples, Nissan, in Sunderland, Toyota, in Burnaston, indeed the Packard, the American-owned Leyland truck plant, are among some of the most productive factories in the world, and there are many other examples, but they are all here in the UK. Yes, there is a risk of migration, I do not belittle that or deny it, but we do have a strong track record and I think it is strong enough for us to resist some of that migration.

Q18 Mr Clapham: Before I come to the exchange rates, can I ask, in terms of what you have just said about the Eastern and Southern European markets, whether we are transferring technology into those markets as well as the Far Eastern markets? What kind of shape is that taking, is it joint ventures, working with larger companies which are there, with university input?
Mr Macgowan: By and large, the technology transfer is to the markets such as India and China, that is our focus, by and large, that is where the emphasis is. Yes, there is some technology transfer, very often, through the world of academia, many of the universities, as you know, have arrangements with one another, we are seeing some of that. The overwhelming direction is towards China and India.

Q19 Mr Clapham: Can I come to the exchange rates then. In your submission, you highlighted the detrimental impact that exchange rates could have, but, of course, we have seen recently the pound/euro improvements, whilst, at the same time, on the other side of the score, there has been a worsening of the pound/dollar exchange rate. Do you still favour early entrance into the euro?

Mr Macgowan: I think our members, the members of this great industry of ours, are interested primarily in exchange rate stability. Again, if I may, Mr Chairman, I will ask Paul to pick up on this point particularly.

Mr Everitt: I think the key is, we have argued very strongly for stability and a competitive rate, and clearly everyone has benefited from the weakening of sterling against the euro, certainly over the course of the last 18 months, two years. It is slightly on the turn again now. I think, predominantly, that has benefited certainly the component suppliers, because they have been under a lot of cost pressures. As you would expect, the euro is a difficult issue for any trade association. I think it would be fair to say that most of the global vehicle manufacturers and component suppliers would prefer to see the UK within the euro because they believe that would reduce risks and uncertainties associated with exchange rate fluctuations, but that is not a universal view.

Q20 Mr Clapham: Given that view, obviously you must have looked at the impact that going into the eurozone is likely to have on firms which market outside the eurozone. Is that something you have looked at, do you have a view on that?

Mr Everitt: One of the big things, I guess, and one of the benefits that we have seen in the UK, certainly over the course of the last four or five years, is the number of vehicle manufacturers now producing in the UK who are specifically targeting the US and indeed other global markets. In the main, I think that, whilst it is a concern, and rates and fluctuations are a concern, the focus of their concern is on the cost base rather than from where they gain their revenue. Clearly it has an impact, but I think they feel more comfortable being able to balance the revenue risks in some of those other markets. As I say, their focus really is on their cost base, which is very difficult with the currency fluctuations against the euro, and very often because there are competitor plants elsewhere in Europe to the ones which operate in the UK.

Q21 Mr Hoyle: Just to touch on a point you made earlier, the Hyundai plant, if the UK was so good, why do you think we lost out in getting the Hyundai plant in the UK?

Mr Macgowan: I think that it is difficult ever to imagine you are going to be able to sweep up all the investors into the UK. There is history involved. There is a perception at the moment that, some of the Eastern bloc countries, they are about to accede into the European Union, they do offer the kinds of labour rates, they do offer the kind of flexibility, and it is a tough call for us, and that was not one which was going to come to the UK. I regret it bitterly, but I have to live with that.

Q22 Mr Hoyle: It seems strange, there is an empty plant in Poland, is there not, and nobody has taken that up, apart from Rover looking at it, but that is another matter? Can I take you on to the big issue last time, that was rip-off Britain and the rip-off car prices, and obviously it was about the block exemption. What impact has the removal of the block exemption had in the case of market share, either at home or abroad? What has been said is that the margins are back up now and the cars are being produced, but what you did not say was how much of the market share we have got. Has it reduced, because there are more people buying new cars?

Mr Macgowan: I am pleased to report that the market in the UK has gone from strength to strength. We are now the second largest market in Europe. We are sitting at about 2.5 million new cars each year and we are one of the few markets in Europe actually which are rising. Many of the other European markets, sadly, actually are declining. As regards block exemption, it has had a number of effects. Most of them, we are still learning what the effects are; frankly, it is too early to say. Certainly, on the retail side, it is the case that there are some signs of consolidation taking place, we have had consolidation amongst manufacturers. Funnily enough, there is some evidence to suggest that consolidation is taking place and that some dealers are buying each other, and there is some enthusiasm for that. Actually, that may not work out in the interests of the way block exemption was scripted originally. As regards the market as a whole, it is remaining very, very strong, but I am sure you understand fully that about 70% of that which we build in the UK is sold outside the UK and about 70% of what is sold in the UK is imported, and that is a function of a truly global market. That has shifted a little bit since we were together three years ago, but not greatly.

Q23 Mr Hoyle: Obviously, we have seen prices come down. What about servicing charges, are they coming down now?

Mr Macgowan: You are right, the prices have come down and that is well documented by the Office of National Statistics. Servicing charges, I do not have any figures to hand. I am going to refer to my colleagues as to whether we have figures to hand in that sector.

Mr Everitt: I do not think we will have seen service charges coming down generally, across not just the automotive sector but the rest of the economy. In the service sector overall, costs have been rising far higher than in manufacturing, so we will have seen servicing costs increase generally but probably at a level no greater than general prices.

Q24 Mr Hoyle: Do you believe still, and there was an article, I think it was in one of the Sunday papers, which said, rip-off Britain still exists even though prices have dropped? It did some comparisons to say are we really still getting a fair price, if you take Land Rover, I think that is a good example, whether it is the Discovery. I wonder if you have any views on that?

Mr Macgowan: Yes, I do. I remember when the rip-off Britain campaign was at its height how very difficult it was to explain to anybody who was prepared to listen that there were a number of factors involved. I think what we have seen over the last three years is that prices in the United Kingdom have come down demonstrably. I think that the statistics are very clear, and I am sure they have had some bearing on the health of the UK market. I have to say to you that, as long as in Europe we have this enormously different tax regime and for as long as we have in Europe cars being taxed in an entirely different way from almost any other product you can think of, we will continue to see these variations. The number of variations has plummeted, and the number of private imports has plummeted, so clearly the pricing thing has worked. You will always have some exceptions. In answer to your fundamental question, consumers know that the UK now is the best place to buy a car and they are demonstrating that in great numbers, and that is why the figures are going up. You will always get, I am sure that I will always be able to quote to the Chairman, and vice versa, the exceptions, but it is a far less varied picture than it was three or four years ago.

Q25 Mr Hoyle: I have just noticed you said there were a number of factors and people would not listen to you. Maybe it was as well they did not listen to you because the price has dropped?
Mr Macgowan: That is right, yes.

Q26 Chairman: Do you think then that the forecasts of doom and gloom that you were giving us three years ago, the impending end of western civilisation as we know it, maybe that was a wee bit of an exaggeration?
Mr Macgowan: I would never, ever, dream, even for one moment, of making any criticism of the Chairman of this Committee, but I think, with respect, that is a slightly selective recall of what I said.

Q27 Chairman: It is not inaccurate. The bits that I have selected were pretty accurate at the time?
Mr Macgowan: Certainly, it was a very difficult time for us. There were a number of factors that we were very, very worried about. In the event, the UK Government and the UK economy have remained incredibly stable through this period. One of the things that manufacturers want more than anything else is economic stability, and that they have had and that they have seen. We have had new products being introduced, we have got exciting cars for people to buy, and you are quite right, mercifully, some of our fears were not realised.
Chairman: We will wait to see if the good doctor Brown gets a Nobel Laureate equivalent from the British motorcar industry, but I think that may be rather long term in realisation.

Q28 Richard Burden: I had better put an interest on the record, to start off with, that I chair the All-Party Motor Group, for which the SMMT and the Motorsport Industry Association provide the secretariat. Can I return to the components industry. We can come on perhaps to what is being done to improve things in the component industry, but first of all can we identify what you think is the problem? The amount of components which are sourced locally, the percentage of cars manufactured in the UK which have got components produced in the UK, is considerably lower than it was 20 years ago. Why do you think that is? What is the problem, how much of it is cost and how much of it is other things?
Mr Broome: The fact is that global purchasing now is the normal pattern of behaviour. Twenty years ago there was very much a localised approach to the sourcing pattern. In that time, there has been a massive restructuring of the supply base, far fewer direct suppliers into the VMs (vehicle manufacturers), and with that rationalisation activity then a look outside of the UK, because, as a matter of course now, people are purchasing on a global basis and the comparisons are very, very transparent. That, I think, is at the heart of the issue. Twenty years ago, to your point, it would not have entered many of the purchasing departments' processes to have been shopping around the world, but now it is and the new technology, such as the Internet, only promotes, encourages and accelerates that.

Q29 Richard Burden: Is there, potentially, a bit of a conflict between, on the one hand, the industry— and manufacturers stress the need for developing long-term partnerships with components suppliers—and, at the same time, because of their wish to source globally and to look globally, to keep components suppliers dangling on a bit of a thread, where their business could go fairly quickly? Is there that conflict, and how do you think that could be addressed?
Mr Broome: I think in the high-tech components then long-term deals are the way, because people are making big investments in the product development and the process development by which those products are made. If you are in the commodity end, of low switching costs, easily sourced, no 'barriers to entry' products, then, yes, life gets very, very difficult, and I think that is why it places a great emphasis on our manufacturers today being globally competitive in their quality, cost and delivery of serial supply. Of even greater importance is that they are looking to the future and making sure that they have some good, embedded technology, and that they are, as we often use the expression, getting into the high value-add products. In that way, such manufacturers are not left, if there are low switching costs, as you put it, dangling on the end of a piece of string.

Q30 Richard Burden: Is there any more you think the manufacturers could do to nurture the components industry here in the UK?
Mr Broome: It is heartening to see the number of manufacturers which are embarking upon full supply chain development. I think, as you know, Richard, through some of the DTI schemes, recently

we have been putting investment behind ensuring that we have got people looking to improve the competitiveness throughout the chain, and it takes a lot of investment and effort on the part of everybody, from vehicle-maker, right the way through. When we look at the total costs, as I mentioned earlier on, there are many logistical, and therefore cost, benefits to people shopping and purchasing closer to home, and the more that we can do to build those national supply chain group activities the better it will be for the UK component industry.

Q31 Richard Burden: What do you think are the respective roles of the industry as a whole, I suppose, yourselves, as a kind of trade group within the industry, and of Government and of firms within the industry, to try to create that virtuous circle you are talking about? What actually needs to happen?
Mr Broome: I think the way in which manufacturers have put effort into things, such as our own organisation, with Industry Forum, where everybody is trying to get a common set of measures and build up a capable, competent bunch of individuals who can go out and provide practical, hands-on assistance to getting the QCD performances up, that is a good example of things done. The DTI's pump-prime funding, which was provided for that, was very helpful. Equally, what we should recognise is, that is at the national level. Regionally, what we are seeing now is more and more regional schemes. You will be familiar yourself with the activities in the West Midlands, with the Accelerate Programme, which is of many years' standing now. In the North East there is the NEPA programme, which is putting regional funding also behind encouraging companies at all levels of the supply chain to carry out practical activities, to boost their skill base and provide people who actually can cope in this more demanding environment. I think it has to be aligned.
Mr Macgowan: Since we were last together, Mr Chairman, the Prime Minister formed the Automotive Innovation and Growth Team, which spawned seven recommendations, whether it is the Automotive Academy, the reorganisation of the Foresight Vehicle Programme, a better way for Government to work with a sector such as ours. As you know, the concept of an Innovation and Growth Team has spread indeed to several other sectors as well, notably the chemicals sector. I think there is a role for Government, in answer to your question, just to be a broker of best practice. The industry can do an awful lot of it itself, but I think the Government does need to be proactive in making some of this happen and delivering messages back to those boardrooms in Detroit and Tokyo, etc., that the UK is serious about the future of the motor industry. Frankly, whilst it is not often I am praising the Government, I think the Government has made a step change in that relationship and it is noticed outside the UK.

Q32 Chairman: On this question of outside of the UK, the outsourcing of the supply chain, if I can put it that way, often is assumed to be only a UK condition. Do you have any evidence of the dependence of the German or French car industries on supply chains which extend outwith national boundaries, in terms of components, and things like that? Do you have evidence of that?
Mr Macgowan: My hunch is that those countries with a strong, local-owned industry tend to have their supply chain close to home. I think, frankly, we are ahead of the game. That is where we used to be 20 years ago and we have moved on from there. I think the answer to your question is that our supply chain stretches far further than I suspect do the supply chains in some of the other markets. Paul looks after our economics area and, if I may, I will bring him in on this point as well.
Mr Everitt: As Christopher mentioned, things are changing. If you look at every major vehicle manufacturer operating globally, in the course of the last two or three years each of them has announced and re-announced cost-reduction programmes. Inevitably, in that process, no company can afford to keep on board companies and suppliers which do not deliver to the standards which are required, and increasingly there is a focus on cost, which means that choices are being made across the board. I think it is not just in the UK where the sourcing patterns are changing. I think that the big challenge is in trying to identify what is going to happen, what are the products and product innovations which need to be made so that you secure, in the component supply chain, some of the intellectual property and being the providers of care rather than the providers of commodity parts, because in that market there will always be someone cheaper than you.
Mr Macgowan: I think, as well, the old-style national boundaries almost had to be abandoned. I will give you, if I may, just one, very brief example. There are many other similar examples, but I happen to highlight just one. There is a very talented group of people working for General Motors in Luton, who have basically a central purchasing role. I met a young man from that particular department the other day, who is buying seats for various different General Motors factories around Europe from a variety of suppliers across the whole of Europe. National boundaries do not come into it, basically it is a global sourcing exercise, and I think we are ahead of the game in the UK in understanding that.

Q33 Sir Robert Smith: Can we come on to some of the concerns you have raised, and particularly the concern about regulation and the burdens that places on the industry. You have mentioned in there, obviously, this final product regulation, manufacturing process, marketing and sales, all different areas which face regulation. Presumably, in terms of competitiveness of manufacturing in the UK, it would be the manufacturing process where the regulation would be distorting, because, presumably, final product marketing and sales would hit anyone else from outside the UK also trying to access our market?
Mr Macgowan: Again, if I may, I will bring in Paul.

Mr Everitt: I think there are a number of areas. Fairly recently, a number of representatives of the European motor industry paid a visit to the President of the Commission to raise with him the whole question of regulation within the European Union, which is posing a problem and creates a competitive disadvantage for those within the EU. Specifically in the UK, yes, predominantly it is on the product and on the product processes, but there are layers of issues. Really it is about an interpretation. In many of the pieces of legislation, Member States have a degree of licence in terms of how they interpret, and clearly that can have a significant impact on the competitive situation. For us, there is just the volume. If you can imagine that across all of those areas, I can think of at least three or four in each of those sections which are current, which are going through the legislative process now. We have a monitoring system which we run jointly with Government, and we stop at 30 pieces of regulation, on the grounds that there are lots more beyond 30 but you cannot focus and you cannot prioritise on that basis. Whilst one is the volume, two, it is the interpretation then in the UK and its implementation.

Q34 Sir Robert Smith: Can I just clarify that. I want to pin that down. Presumably, surely, anyone supplying the UK market is going to be faced with the same product burden, whether they are importing or manufacturing here?
Mr Everitt: Yes.

Q35 Sir Robert Smith: You highlight two examples of gold-plating: the Solvent Emissions Directive and the Emissions Trading Scheme. Do you have other examples in the manufacturing process where maybe the Government have gone faster than the EU?
Mr Everitt: There is a range. In not all areas is it a question of faster, but again it is how things are interpreted and the speed at which they are doing it. There is the whole question of Integrated Pollution Prevention and Control, which is a huge piece of legislation, and there are various elements which are brought in at different times. Certainly, the relationship between the industry and the regulating authorities in the UK is very difficult. That is a significant batch within that.

Q36 Sir Robert Smith: Do you have any examples of UK-generated regulation in areas which are not in the EU competence?
Mr Everitt: In the main, obviously, regulation tends to be European for our sector, so that is the main focus. At a UK level, it will tend to be the tax environment. A particular concern for the sector at the moment is the whole question of the new Pensions Bill and the creation of the Pension Protection Fund. Again, as an industry, we provide final salary pensions, and I think the industry generally takes a responsible view and sees that as one of the big benefits it offers to its employees. Clearly, though, anything that adds cost to the UK and feeds directly into the bottom line on manufacturing operations is a cause of concern, and so, clearly, one of the issues that we are pursuing is trying to ensure that the Pension Protection Fund and the levy imposed is at a minimum level.

Q37 Sir Robert Smith: Presumably, you would want to see the funds based on a risk assessment, rather than a plan?
Mr Everitt: Very much so.

Q38 Sir Robert Smith: I suppose, the one devil's advocate question, and someone from the Government can come back, is that, if the UK is more of a challenge regulatorily, how come Nissan is so high-flying when it is based in the UK rather than in mainland Europe?
Mr Everitt: It assumes that everything stays as it is. Essentially, what we are trying to do when people raise these issues is, in order to ensure that the manufacturing and the output stays as it is—whether it be Nissan or any of the other companies—the model turnover is much quicker than it was once, so a model normally would be about five years, there will be a new model which comes into each of our plants. We are in internal competition with the other plants within the various VM groups, all of the time, to secure additional investment, or the new model, or the new investment, so ensuring that the regime in which they are operating is as competitive as the other plants is terribly important. It is an ongoing war of attrition, essentially, that everyone is faced with, because plans are already being made for what will happen in three and four and five years' time, and so the sentiment, if you like, when investments are made is terribly important.

Q39 Judy Mallaber: Despite policies like R&D tax credits, in your evidence you point out that R&D spend is still worryingly low, and you give some statistics showing how we do worse than the EU average, and particularly worse than America. Is that a serious threat to the continuing success of the sector?
Mr Everitt: We think that, in the kind of world we have described, where it is product innovation and high-value manufacturing which will secure the sector longer term then, yes, R&D, and expenditure on it, is very important. If you look at the big vehicle manufacturers, I do not think we believe those are the people, there are some who are investing already in the UK and do work in the UK, but it is very important for the components supply industry that they invest more and look to improve the products that they are offering. That is the area we are focusing on mainly.

Q40 Judy Mallaber: Is it the responsibility of the industry itself to remedy matters, or are there areas where you think Government should be doing more than it is at present?
Mr Everitt: Certainly, as an industry, we welcome the R&D tax credits, and particularly the recent confirmation of the broader interpretation, so that development and a range of other things come within those terms. I think that is a good thing and

that will have an impact. The biggest challenge we face is that many of the companies we are looking at in the component supply chain are relatively small, and they do not have necessarily all of the skills and wherewithal to go about creating R&D programmes. I think there is still a role for Government alongside the industry itself in trying to communicate what is available and how we go about it. We are fortunate within the SMMT that within our membership we have also a whole range of design engineering and consultants who tie up companies, who, because of the relationships we have within the SMMT, are able to build contacts, provide information, and that kind of thing. There is still a culture gap, if you like, which needs to be closed, about when money is available the first thing on people's minds is not necessarily to use that money to invest in new products.

Q41 Judy Mallaber: What can be done about it, and is it up to you and the industry, or are there specific recommendations you would like us to be making to Government or any other agencies?
Mr Macgowan: Certainly I think that you have a very good model in place with something known as the Foresight Vehicle Programme, which does help in this process, so there is something in place. I think we would like to see more of it, I think we would like to see that economic climate enabling more of that to be delivered, but, fundamentally, it is down to the industry to encourage those companies which, as Paul said, are not well equipped to do it. It is down to us to encourage them, but the financial, economic framework needs to be there for that to happen. Once again, it is a partnership thing between Government and the industry.

Q42 Judy Mallaber: Are there any particular recommendations you would like us to be making which would assist in that?
Mr Macgowan: The Foresight Vehicle Programme, as I say, is up and running and it is proven. I think we would welcome very much the Committee giving thought to whether or not the Foresight Vehicle Programme should be ramped up, in terms of the size and the scale of the work that it does. It would be inappropriate for me to be seen to be lobbying the Committee, but I think that would be something that we would welcome being looked at.

Q43 Judy Mallaber: Is not that what you are here for?
Mr Everitt: Also, under the AIGT report, there are two, what are termed, "centres of excellence" being developed, one for telematics and one for fuel cell and low carbon technology. Whilst they are developing, shall we say, they are not moving along at the speed at which we had thought originally perhaps they might.
Mr Macgowan: A kick up the backside in that area perhaps would be helpful.

Q44 Richard Burden: This follows on a bit from that question really. Do you feel there is any more that could be done particularly to try to harness and make the most of research expertise in British universities and linking that together with what the industry needs for the future?
Mr Macgowan: Yes, I think there is some work that could be encouraged, and I will ask my colleague, Graham, to step into that, on some of the work that is being done.
Mr Broome: I think, very much, Richard, with the Automotive Academy, what we are trying to ensure is that actually we are making all the linkages which are appropriate. As I am sure everyone is aware, this is a very complex situation. Universities move at a great rate of knots, so do the companies, so we see it as a very, very important issue that actually we bring the supply and the demand sides closer together. I think it is a pretty good success story but there is a lot more yet to be done on that.
Mr Macgowan: There are some famous examples, with which you are familiar. The Ford experience with Loughborough University is best practice by anybody's standards. The Toyota experience with Nottingham Trent would be best practice. I guess Jaguar's experience with Coventry would be best practice. There is some good stuff around. Frankly we need more examples and more of it.

Q45 Richard Burden: Are you satisfied with the mechanisms that are being developed to spread those kinds of best practice, whether it is the Automotive Academy or other things?
Mr Macgowan: No, I think it is too cumbersome, it is just complicated and cumbersome, and we would like to have some simplification.

Q46 Richard Burden: How could it be simplified?
Mr Macgowan: I think it comes down to the dreaded subject of money. I think, if it were possible for companies to be given some form of incentive to spearhead these arrangements, that would be very, very helpful. At the moment, it is an extremely expensive operation and it is an enormous act of faith long term that you are going to see the payback, and the examples I have given are run by companies which do see that payback. I think it would be (a) simplification, or (b) a tax break or cash, to enable us, as an industry, to do more of it.
Mr Everitt: I think the situation at the moment is somewhat clouded, but the DTI have been conducting and recently have published their Innovation Strategy. They are due to publish shortly, I think, their Technology Strategy. A number of the relationships have had to be put slightly on hold while this review goes on and, to a certain extent, we are still waiting to see quite how the changes will impact on the relationships which exist already and how the direction may change as a consequence. It is an area which is slightly in transition, basically, so it is quite difficult to say. Clearly, we are not where we were three or four years ago, but the direction of how Government is going to intervene, with the money and resources that it has, is not yet clear.

Q47 Richard Burden: I am struggling just a bit to know exactly what needs to be simplified. I understand that, in a sense, you would wish for more money, that is one of the areas to be expected, but is it the procedure for applying for a hundred tax credits that needs simplifying?

Mr Everitt: We are still trying to get experience on it. The key area is that many of the sources of grants, and even within Foresight, which is presented very much as a programme and actually it takes money from three or four different sources, much of the funding for this, whilst rightly it is supposed to ensure that what you are doing is pre-competitive, but very often it is so pre-competitive, in order to get the funding, that actually it is not five years away from being something that would be in a vehicle or developed, it is 20 and 25. Those kinds of rules, which stipulate that you cannot do something which might have a payback within a reasonable period, are ones which deter companies from putting their money into those kinds of collaborative ventures. If it has got a payback and they know it has got a payback they will do it themselves. If it has got to be so far ahead of the market then probably they will not bother.

Q48 Richard Burden: The motorsport industry has been recognised recently as having been both quite an important industry and quite a catalytic industry in the UK. Do you feel enough is being done, in terms of developing links between, if I can put it this way, mainstream automotive and the motorsport industry?

Mr Macgowan: I think there are some opportunities. Members of the Committee will know that many of the Formula 1 teams are still based here in the UK, and that is the tip of the iceberg. There is a great deal more motorsport going on also here in the UK. I suppose it does have the glamour, it is the glamorous end of the industry. Certainly, there are some opportunities and we are looking at those at the present moment. There are some opportunities, and we hope to exploit some of them. I would say that, in essence, the best opportunities are in the whole area of technology and development, and we get back very much into some of the areas which my colleague mentioned just now. It is a great prize that we have got in the UK and we would like to use it more.

Q49 Mr Berry: On technology, in your written submission you referred to R&D on low carbon and fuel cell technologies, and so on. Is the Government doing enough to ensure that the UK is at the forefront in developments like that?

Mr Everitt: I think it would be difficult to say, if you are looking at fuel cells, that somewhere in the UK is going to become the centre for fuel cell development, when, if you look at the States or Canada, they have been pursuing programmes quite actively over a long period of time. When we reviewed this during part of the AIGT process, one of the reasons why there was a big focus on low carbon and fuel cells and why we wanted a centre of excellence was that these were sufficiently far away from the market to mean there was an opportunity for the UK to catch up and to create its own competitive advantage, not necessarily in producing fuel cells but in the technologies that you would require to commercialise the fuel cells. It might be how it fits into a vehicle, some of the refuelling technology, there is a whole range of opportunities, because there is going to be this fundamental, significant shift in technology, whereas if we could focus sufficient attention on it then there would be spin-off benefits for the UK and to provide competitive advantage. That is very much the focus of the Low Carbon Vehicle Partnership, which was one of the spin-offs of the Government's Future Vehicles strategies, I am sorry, I am getting confused, there have been so many different reports. I think the Government understands what it needs to do and we are seeing things being put into place. Inevitably, there is always an argument that they should be doing it faster and more money should be spent, but there are always going to be limits.

Q50 Mr Berry: What more should the industry do?

Mr Everitt: In a global market, it is not easy to say we should do what is right for the UK. I think all the people who work in the UK, the global vehicle manufacturers and the component suppliers, want to secure competitive advantage for the UK, but that means you have to spend money, and persuading your global bosses that you should increase investment in the UK in specific areas is not an easy task. What we are embarked upon is a longer-term process about demonstrating that the UK is a good place for the industry, first and foremost; and that the environment, in terms of the regulatory environment and tax environment for the vehicles in the UK, is an attractive one, so that the UK is perceived to be the launch market for new developments and new technologies, which, in turn, gives us an opportunity. We have a degree of specialism in some of the development and engine testing work, and over time you attract more and more investment into those areas which you are good at, which builds up a centre of excellence or a recognition across the world that this is a place where this type of work is good to do.

Mr Macgowan: Put another way, at the moment we have got an unrivalled reputation in existing technology in the UK and that is in the engine area. There are very few other markets around the world where there is as much technology, research and development going on, on the engine side of life, and, indeed, as many different engines plants, and that has got critical mass and you see it being just added to and added to and added to. A quick trip up the A13 to Ford at Dagenham demonstrates that. In a way, that is what we would like to see start happening in other technologies.

Q51 Mr Berry: That is because there is already a critical mass there. To paraphrase Mr Everitt, he seemed to be saying, really, clearly this is a global industry, clearly other people are engaged in R&D, there is no obvious reason, in the short term, why the UK industry should put too much money in this area, clearly it is a matter for public policy, almost. If the Government wants to put money into more R&D for low carbon and fuel cell technologies, fine, that is based on a decision that activity should take place in the UK, that is a matter for Government. You are saying almost that is the reason why the industry believes it should be Government money rather than industry money which is going into those areas. Is that a fair summary of what you said?

Mr Everitt: That was not the impression I was trying to give. I do not think I was trying to suggest that it should be Government that puts in the money. I think, inevitably, it is a question of how you go about attracting more of the global investment which goes into R&D to be made into the UK, and you are not going to be in a situation where today there is not any and tomorrow there is going to be loads because you have done one or two things. It is a long-term process, which says that we do have excellence in the UK, both in manufacturing and in engine technology, in particular. We know where the future is going to be, because we are looking at it, it is going to be a lower carbon future and might possibly be a fuel cell future. What we should be trying to do is ensure that we are building the expertise in those areas in the UK, so that we have a better chance of winning some of the global investment from those areas.

Mr Macgowan: A good example really is what happened on Friday of last week, where Corus, formerly British Steel, Corus Automotive, elected to move their development and engineering centre into Warwick University. In so doing, it believes that it is going to gain critical mass from that decision and also, if the economic climate is right, it will attract additional projects. That is the spirit of what we are saying to you. The climate has got to be right, but ultimately it is the industry that puts in the money, not the Government.

Q52 Mr Djanogly: If global traders do not want to put money into national projects, are you suggesting then that the impetus for bringing on this technology should come from a multinational government approach? Are you saying that not enough is being done, or would you agree that if more was done on a multinational government approach then the industry might respond more than it has?

Mr Macgowan: We have got some fine, fine universities, doing some fine, fine work, as I said, much of it in conjunction with the global corporations in our industry. We just want to see more of it being attracted into the UK. I hope I am not going to be a hostage to fortune, I do not think the money so much is a problem, it is a question of creating the right environment. In just the same way that Nissan selects Paddington for a design centre, because it knows it is the right place to be, we want to create the environment which makes that same corporation decide, "Yes, we want to put more development and people and effort into the UK rather than into Germany." It is the creation of an environment which makes that possible. That is what I am after.

Mr Everitt: We have already got within the UK a number of programmes which are being run which encourage R&D and demonstration projects, and various different vehicle manufacturers are involved in those. It is not like there is not anything there and that they are participating, it is a question that to succeed long term you have to ramp up that level of investment, and similarly to draw the components suppliers into those projects. It is a long-term strategy.

Q53 Mr Djanogly: Is this an area where you feel that the European Union is pushing the industry along, to any extent, or what?

Mr Everitt: The European Union always appears to be looking to regulate in some way, which means inevitably that we have to develop more technology rather more quickly than ideally we would like. Particularly looking at hydrogen, there are a number of European level schemes, or projects, but at the moment I think they are all of the "gazing into the future, wondering what it all means" variety, rather than being focused on specific areas of technology or on specific projects.

Q54 Mr Djanogly: Some UK car plants are amongst the most productive in the world, but they tend to be Japanese-owned. What could be done to improve productivity amongst the others?

Mr Macgowan: I agree with you that the perception is that some of the most productive plants are Japanese-owned, but I think I have to say, in defence of any of the other plants who are also up there, they are not all Japanese-owned. The Japanese have an unrivalled history and we welcome them and what they do is fantastic, but I mentioned earlier that there are other plants which are absolutely at the top of the tree. What a huge credit it is to Ford/Jaguar that, at their last report, it is up there with the most productive plant, I think Ford said last week it is their single most productive car plant in the world. Really, in the UK, we know how to do it, we know how to host these plants, we know how to get the most out of them. It is the case that the way was led by our Japanese colleagues and that is a huge plaudit for them, but it is not only the Japanese plants now.

Q55 Sir Robert Smith: Do the Japanese find that their plants here are more productive sometimes than the ones back in Japan?

Mr Macgowan: Yes. One of the best days I had in the last year was when I was invited by Toyota Burnaston to witness the first Burnaston-built Avensis cars being shipped back to the domestic market in Japan, a huge credit to the workforce and everybody else at Burnaston. Yes, you are right, that is how it all started, and I think we have taken it up a level, and my colleague, Graham, has done so, with so much of the work that he has done. We have increased that productivity even above what I think our Japanese colleagues originally thought was possible.

Mr Broome: Once again, it is an obvious point that is worth stating. With so many of the VMs all purchasing components from the same supply base, and with that supply base representing such a huge proportion of the costs, we can see how this productivity virus, in the positive sense, is able to spread to the benefit of all.

Q56 Judy Mallaber: Are the Regional Development Agencies being useful, are they providing a source of useful support for the automotive industry?

Mr Broome: The answer to that is, yes. What we see is, from our perspective, it is an advantage to have people who are able to be rather more rapidly responsive because they are closer to the issues. There is a risk, of course, and that is, in this global industry of ours, to fragment further can work against us, therefore we have not been idle. Only last week, together with Toyota and indeed some of the aerospace industry, we went down to meet with all of the Chairmen of the RDAs in order to discuss how we can work together on a Sector Skills Agreement, so that we can ensure that we have got a national framework within which the RDAs can operate. That was extremely well received, I am very pleased to say. The RDAs themselves were keen to point out that they benefited, and valued an industry which has tried to get its act together behind the scenes then to come forward and say, "Right, we will take ownership of the responsibility of working to the Government's agenda, which is looking to the Twenty-first century skills through to 2010, so that we can harness some of the productivity-improving issues" which have been mentioned earlier on. In this microcosm of the global market-place, to get the richest of mixes, align that with the NVQ system which then we can roll out through the regions rather more quickly than if we try to do it purely from a centralised situation, which has all the necessary inertia which goes with that.

Mr Macgowan: I think that is all very good news, and that is why the RDAs are working together, we would claim we are bullying them slightly into working together but nonetheless they are working together. The bit that I do not understand is how it is possible, when we come to another subject, like inward investment, I just do not understand how it can be a good idea for many of those RDAs to have an attitude which is "I don't really care about the rest of the United Kingdom, I want the investment in my patch." I remember being at a bash, I think it was at the British Embassy, in Tokyo, and Japanese businessmen were being approached by individual RDAs who were saying, "Don't take any notice of the East Midlands. What you want to do is come down to Wales." I thought, "These poor blokes and women who are running these enormous Japanese enterprises, that cannot be the way to go." Surely, on inward investment, the role is to get the investment into the UK and then figure out subsequently whereabouts in the UK it goes. I must say, I find that a real struggle, as regards whether that is an efficient way of attracting inward investment.

Chairman: I think it is one that we have encountered as well.

Q57 Judy Mallaber: When we wanted Toyota in Derbyshire, it was a huge wooing exercise to get it there. Take Toyota as an example. What should they be able to expect, in a practical sense, which would assist them, from a Regional Development Agency, or Regional Development Agencies working together? What would they want out of that and are there ways in which they or other companies could be assisted, in practical terms?

Mr Broome: I think, if you have a look at the supply chains, it is critical that even if your immediate tier one supplier is close to you then, when you have a look at the sub-suppliers into those, very rapidly they spread across the UK and, as we have talked about earlier on, often outside the UK. What would Toyota expect? If there is a consistent framework of assistance for those suppliers, if there is a National Vocational Qualification system that is similar across the piece and no regional sub-division thereof, that is going to be to their enormous benefit. Quite clearly, that was the point that we were putting across last week. The national framework is something that international companies and the national government have to work on, but then it is almost a competitive race to see who can implement standardised operations of Vocational Qualifications, and ideally some of the grant regimes, so that there is no confusion. When a purchasing individual travels from Burnaston, if you are fortunate, but more likely Brussels, possibly Tokyo, that they do see the UK as one face presented, one set of solutions, even if there are tweaks at the local level that are below their radar chart.

Mr Macgowan: Mr Chairman, if my information is correct, I think you have Toyota appearing before you later in this inquiry and I hope that you may be able to address the question to them directly, because I think those are the sorts of answers that you will be receiving.

Chairman: Thank you very much. That will be helpful.

Q58 Mr Hoyle: Do you think the Regional Development Agencies could play a bigger role and enter into discussions with the regional police forces, the constabularies, to stop them buying overseas cars? It seems fairly odd that if you went to Germany or France you would see indigenous industries, their cars being used by their services. Do you not think it is a role that Government and the RDAs ought to be playing in the police force and saying, "Look, frontline vehicles, surely you ought to be backing British industry, as it's British taxpayers' money that's being used." The same with the Ambulance Service, we have the finest vans built at Southampton and yet time and time again we see Mercedes vans. That does nothing for British industry and all it is doing is stripping the British taxpayer of money?

Mr Macgowan: I have enormous sympathy with what you are saying, but you can tell from the way I am answering the question that I do not agree with you. I think, honestly, that anything of that sort, no matter how well intentioned, and I know it is well intentioned, ends up either being protectionist or looking like being protectionist. I think, in the UK, one of the great things we have got in this country is that we stand up on our own two feet, on merit, and if I am manufacturer X my product stands up on its own four wheels, under its own credit. Really it is good that people make decisions as to how you are going to have that. There is no nationalistic feeling about the way in which I should buy my car, or indeed the way local authorities buy equipment. I think, on balance, that is probably the right way to keep it. I know where you are coming from and I respect it but, on balance, I think I prefer the open approach, the "stand on your own two feet or die" approach that we have in the UK culture, harsh though I know that is to say.

Q59 Mr Hoyle: It is an interesting comment, because what you are saying really is that when we play cricket we play by the rules and yet all the teams we are playing against will not even let us into their protective markets. It seems very odd, like the Japanese vehicles we see, certainly you would not see a German police car being used which was British-built. What I am saying to you is that, yes, it is great that we play cricket, but do you not feel that the rules ought to be the same and we ought to use the same level playing-field? Just out of interest, what we do know is, and I think you ought to be aware of this and I would have thought you would do a bit more research, the message is quite clear, that foreign companies deliberately will ensure and engineer the market share in the product of a highly visible police car. There will be discounts, after-sales service, you name it, in order to get that product on the road in that foreign country. Are you not worried about that, and, if you are not, I think there is a question-mark over your judgment?

Mr Macgowan: Of course I am aware of the accusation that you are making. I have to say to you again that where companies put all of their marketing effort and where they want to be visible—I notice that Jaguar has done a deal with Tim Henman this week to raise the tone of that brilliant brand—is entirely up to them. I am just implacably opposed to anything that smacks of a protectionist way of doing business.

Q60 Mr Hoyle: Just so that I am clear, you do not mind them being protectionist or having a protective market, as long as we do not?

Mr Macgowan: I would much rather they did not, of course, but I do not think that gives us the excuse to do it ourselves.

Mr Hoyle: So you carry on playing?

Chairman: I am not sure if the British car industry wishes to emulate the success of English cricket, but that is a different matter, I will leave that to the private grief of people. More significant, I think it was the Italian rugby team which had Jaguar on their sweaters on Saturday afternoon. I noticed they were suffering.

Mr Hoyle: And we know the result, Chairman.

Q61 Chairman: Yes, indeed. That is the point, I think.

Mr Macgowan: May I say, I cannot speak for Jaguar, but I would imagine that, if I am aspiring to improve the performance of my brand in Italy, possibly that is a very good marketing decision to make. I am not an expert in this area, but that is why people do it.

Mr Hoyle: Just on this last point, the difference is that giving a car to Tim Henman is one thing, but I do not see how you can even compare it with the police vehicles and the huge volume of police vehicles that are riding round on the motorways. I think you have totally, deliberately missed the point, but I accept that you do not want to answer it correctly.

Q62 Chairman: Also, it raises a question, for us as taxpayers, about the purchasing policy of the Police Service. Why police Chief Constables need to go round in Range Rovers and fly a Union Jack on them, when everybody else can live in normal size cars, escapes me, and the need for helicopters, which are much beloved by Police Committees. I am sure they are very useful for taking councillors around the country, but I think that is another matter and I do not think we need to go down that road.

Mr Macgowan: I am hoping that might be slightly outside my remit, Mr Chairman.

Q63 Chairman: I am not sure if Greg Rusedski is getting a car or not, but we will find out probably later today. The Automotive Academy, if we can perhaps elevate the tone of the discussions once again, it has been established, you mentioned it *en passant,* and perhaps you can give us a wee bit more information as to the skills shortages that we are trying to address there and how you feel this organisation is beginning to develop?

Mr Macgowan: As you rightly say, it came out of the Prime Minister's and the Secretary of State for Trade and Industry's Innovation and Growth Team, it was one of the recommendations. My colleague, who is very close to the Automotive Academy, will answer the question.

Mr Broome: I think you are right, Chairman, to touch on the issue of the skills gap, because we have said many times here today that we want to be in the high value-add sector of our industry and we are going to need high-value skills. If we look at the Academy's objectives, they are to make sure that we have got globally competitive content, globally competitive trainers and globally competitive assessors with every product which the Academy develops, or hall-marks, or kite-marks, or validates, and the assessors are absolutely critical. At the moment, we have got a Chairman appointed, I am delighted to say, in the form of Joe Greenwell, out of Jaguar. Although the official launch does not take place until October, we have actually got three programmes which are being piloted currently. The first one of those is at the team leader level, where it was agreed by everyone who was on the Board this is a pivotal level, the first line of leadership in our factories is of critical importance if we are going to be competing globally. That is being piloted in the North East and the Midlands. The first 20 people have finished their, if you like, classroom training and are embarking now upon the NVQ assessed application side of the programme, so that, hopefully, within three to six months, we will have a number of people who have been through a programme which honestly can be said has got globally competitive content and trainers that have gone with it. The second element is that of the automotive leaders, with Cambridge, where the first six or seven people will be going through that, starting in a month's time, or so. Last, but not least, is a graduate programme that BMW have played a very strong role in shaping, so that we can get some of the new entrants, but we are not capturing enough of the best people coming into our industry. Those are the three prongs at the moment. We have had some very, very good support from the LSC (Learning and Skills Council), both nationally and in the regions, because although we are talking about the RDAs and the regionalisation we are pleased to see the way in which the LSCs are aligning themselves with the work that the Academy hopes to do. We do see, and Christopher made the point earlier, on the issue of simplification, there are a bewildering number of National Vocational Qualifications in this country. One of our objectives basically is to rationalise those down to a manageable number which then we can promote actively throughout the supply chain, so we can get people at all levels upskilled, if we are going to have a future in this more demanding, continuously productivity-improving expectation world that we live in.

Q64 Chairman: That is fine, as far as assembly productivity is concerned. What about servicing, are you going to turn your attention to that issue?
Mr Macgowan: Surely we are, yes. As you know, the Secretary of State, Charles Clarke, has introduced a series of Sector Skills Councils, and the automotive industry, being quite large, has got two of these. One looks after the manufacturing side of life, but recently Automotive Skills Limited was launched by the Secretary of State and specifically it looks after the retail sector and is going to be addressing just those issues, to get, again, the consistency going through the entire retail sector. Why do you want to do that, so that the consumer experience is improved when people improve. That is very much at the centre of the way they are screened by the Government and the industry.

Q65 Chairman: Just one last point on this issue. The further modification of the block exemption is going to cover servicing and no longer will people be obliged to be locking into badged servicing centres, as it were, and how do you see that? The general feeling is that it did not guarantee service in the way it had been intended. How do you see the industry addressing this challenge now, when one would no longer be obliged to go to the local dealer-cum-garage for servicing?
Mr Macgowan: We are in the middle of delivering that which the block exemption regulation demands, and, of course, the Office of Fair Trading have a very big role to play in this to make certain that we comply with the rules. I think you are right, Mr Chairman, I think that consumers will understand that they are free to take their car for service work wherever they wish to, provided the work is done to an appropriate standard, and those that wish to do so will do just that. It is an interesting dichotomy, that, in actual fact, it is the case, as you say, that many consumers actually wish to remain within the franchise network, and do so, and some wish not to and they will be free to do that also. Provided the standards are met for service work, which they will be, I think that it will give consumers real choice, which is what it was intended to do.

Q66 Chairman: Is it the case that some of the servicing is dependent upon specialised equipment, which is still going to be within the control of the car manufacturers themselves, so that by drip-feeding this equipment on to the service market they would still be able to dictate who would do the servicing?
Mr Macgowan: I think that the Office of Fair Trading will take a very dim view of that position. The reality is that manufacturers are obliged to make authorised repairers a possibility, some will have many, some will have few, and it is something which is happening and will happen. Some of the manufacturers have got very advanced programmes whereby they are setting up authorised repairers as we speak.

Q67 Chairman: Do you see your role as the trade association having any policing function in this, or do you see that being left to the OFT?
Mr Macgowan: No. Obviously, the OFT is Brussels' police force, so the answer to the question is, yes, it is down to the OFT, but our role is to underline to our members, if they need it underlining to them, and to date that has not been the case, what their obligations are, and they are rising to the challenge. You will see authorised repairers emerge and consumers will have that option.

Q68 Chairman: You understand why I am asking that question, because the block exemption has been in place for a while, you have been one of the organisations, you might say, responsible for maintaining standards and these standards have not been very high. Hence the recognition of that by the removal of the block exemption obligation. So you have got to get your act together as well, I would imagine, on this?
Mr Macgowan: I am pleased to tell you that we are doing precisely that. There is a new Code of Practice in place with the Office of Fair Trading which addresses just that point. I am very confident that the

spirit which was laid down in the new regulation will be fully translated into reality. There is no future in anybody trying to hold back from that. It is enshrined, it is there and you would be making a mistake not to embrace it.

Chairman: On that point, Mr Macgowan, can I thank you and your colleagues. As always, we say if there is additional information we may well get back to you in writing, but thank you very much for your evidence today.

Witness: **Mr Steve Hart,** Senior Regional Industrial Organiser, Transport and General Workers' Union, examined.

Q69 Chairman: Good afternoon, Mr Hart. Can I welcome you here. I think, on previous occasions when we have looked at the car industry, it was Tony Woodley who came along, so this may be the seat which catapults you on to other things.
Mr Hart: He has moved on to more exciting things.

Q70 Chairman: Indeed, and all the rest, it is there for us to see, but can I say we are very pleased to have you along this afternoon. I think you have been sitting in, so probably you have heard a number of the areas we are concerned with. It was gratifying to hear that there has been something of a recovery in the British car assembly and truck assembly activities. Sadly there is a downside to that, insofar as it seems that the components which are assembled in the United Kingdom perhaps are not as many in number as once they were, in fact, we know they are not as great as once they were in numbers, that now there is far more sourcing from outwith the United Kingdom. What do you think can be done about this, either by the Government or by industry itself, to try to reverse this trend?
Mr Hart: First of all, I think there was a somewhat optimistic gloss put by the SMMT, as they would, perhaps, about production. In fact, between 1996 and 2003, total UK vehicle production went from 1.68 million down to 1.65 million, there is no recovery there, actually it was stable through that period. That was a time when car registration in Britain went from 2.02 million up to 2.57 million, so half a million extra sales, and that has been a steady progress in sales and car production remaining absolutely static. We have got now, roughly speaking, a one million car deficit, sales versus production, and that is a serious problem. That is what you would expect when we have lost two major plants, each with a capacity of about a quarter of a million, so there is a serious problem there. That is reflected then, to some extent, I think, in the components sector. One of the problems that we have got is that we are just on a knife-edge off having sufficient production in this country to sustain local component manufacture, and that is why really we have got to give it a lot of attention. I was looking at *Automotive News* recently, and supplier parks are very important, the big car plants, today. We have got two supplier parks in the UK, at Ellesmere Port and Halewood, and I think there is one developing a bit around Jaguar. Whereas, if you look at Germany/Belgium, there is a central belt of automotive manufacture around there, there are about 12 supplier parks. A supplier park is where the final assembly is of the tier one suppliers, they put the components together. The major components suppliers participate in a supplier park, and that gives the magnitude of the problems that we have got. It is absolutely critical that we maintain production and expand the production we have got and then ensure that the tier one suppliers are manufacturing here in all sorts of different ways.

Q71 Chairman: Who do you see as leading the charge on that? Is it the Government or is it the industry itself? You have identified the problem quite graphically, what would you suggest?
Mr Hart: I think it is a very difficult problem. One of the problems the components sector faces is that, with the competitiveness of the industry, the big manufacturers are bearing down very heavily on the components sector, which then bears down on the next tier down, with all the pressures that entails. The way forward will be, as that pressure builds up, whether or not that is translated into new investment, new production techniques, and so on, which modernise, or whether sometimes it is moving out of Britain elsewhere, the Far East or Eastern Europe, in terms of some of those facilities. I think Government has got a very important role in having a relationship with the manufacturers to reduce some of those pressures, having partnerships with the component manufacturers to ensure that they retain their production here, and, technology is more and more important in the car, electronics become a greater and greater part of value added, to ensure that new products are sourced here and that the second-tier components are sourced here as well.

Q72 Chairman: You heard what the SMMT said. They recognised there was a problem but they did not necessarily put it quite as starkly as you have. They said that there was a tendency, where there was, as it were, indigenous ownership of car production, there was a greater incentive for locally-sourced components. In the case of Belgium, I am not sure if that would run necessarily, but in Germany, in the Federal Republic, certainly it would, although it might be argued equally that the close proximity to them of components suppliers in, say, Poland, the Czech Republic, Slovakia and Central Europe generally, Hungary, have you done any work on that?
Mr Hart: Clearly, it is one of the major problems that we have got in Britain now, that we have not got any really major domestic champions, obviously there is MG-Rover, but in terms of an indigenously-based national champion, we do not have that. In Germany, the weight of Ford and General Motors is

seen increasingly as German, to an extent, they have a sort of sense of the German base, and then the indigenous manufacturers in France, obviously, Fiat. The Japanese manufacturers will have their family members, either based in Japan or outlets will be sourced sometimes close to manufacturing sites, sometimes elsewhere, but determined back in Japan, rather than building up the networks. As with main production, the problem that we face, time and time again, as somebody was saying, we play to the Queensbury Rules and every other country plays it free for all, and the end result is, when push comes to shove, if there is a difficulty, it is a British plant which tends to go, whether it is the components sector or the main industry. That is a problem that we have to face and deal with, Government has to deal with that.

Q73 Mr Clapham: Mr Hart, you were in the gallery when we had the previous group making their presentation and you heard them say that there is enormous competition, global competition, of course, and you have referred to the fact yourself that there is some overcapacity. Given that situation, how do you see the UK industry responding to that? Are we likely to see more consolidation, could there be job losses, or is there something which can be done to offset the negative side of the change?

Mr Hart: As the SMMT said, and we would stress as well, we have got many world-class manufacturing sites, in assembly and engines, and so on, and that cross-ability, we are very competitive. In Britain, we have a lack of capacity rather than overcapacity. Clearly it is a European market, but, as I said earlier, we saw an increasing market, unlike the rest of Europe, it has gone up to 2.6 million, but we produce only 1.6. That says to me we have an undercapacity. We have faced a problem in the past with world-class manufacturing sites. Luton, for example, was regarded internally as equal to or better than its competitor sites in Europe, similarly Dagenham. Contrary to some myths, Dagenham, in terms of productivity, cars per head, etc., was seen as highly competitive. Yet when the boardroom decides it is easier to eliminate capacity in this country, as compared with Germany, whether it is a requirement for social plans, whether it is a requirement to consult with a supervisory board, whatever the details or regulatory framework, it is a fact, it is easier and cheaper to dismiss people in this country relative to elsewhere. We still have problems. Only in the last few weeks the closure of the Ford Averley plant has been announced. That is a small pilot plant with highly-skilled people, and that has been announced, in spite of the fact that Ford announced, after an investing and sourcing agreement after the closure of Dagenham, that Averley was definitely staying open. They signed it and said it was a legally-binding agreement, but then they come back to us and say, "Well, the world changes, we had to close it." We have had several other plants which are not out of the woods. In particular, the Ellesmere Port engine plant is facing closure. We should be getting other products sourced there. It is seen as an extremely competitive plant globally. The ECU (Engine Control Unit) engine is a technology which is moving on, it needs a new product, but at present, without major intervention, that plant is under serious threat. There are a number of other plants which compete with other plants on the Continent, and we do need not a light touch but a fairly strong touch in Government to ensure that the various plants do stay open and do not come under the cosh when there is some retrenchment because of overcapacity at the European level.

Q74 Mr Clapham: Taking that on board but at the same time bearing in mind the impact that the fluctuation of different exchange rates could have, do you feel that entrance into the eurozone is likely to give any stability?

Mr Hart: Firstly, it is interesting that Lewis Booth, who is the President of Ford of Europe, said in the FT the other week that, with the benefit of hindsight, he realised that if Dagenham had not closed they would have saved $90 million, I think it was, because of the fluctuations in the exchange rates. I think stability is what is wanted and, as the SMMT said, the stable economy is very important. Stable exchange rates are valued in the industry, however, they also hedge, to a great extent, and so fluctuations are not important, in that sense. In Britain, the relationship with the euro is a key issue but also the relationship with the dollar. For example, because of exports to the US, Jaguar, Land Rover, and so on, are looking very much at the rates with the dollar. While a stable exchange rate, by entry to the euro, obviously is a positive reason for entering the euro, our view would be very much in line, I suppose, with the Chancellor's, that is on the positive side. There are other factors, in terms of the overall economy and the stability of the economy which also need to be taken into account.

Q75 Sir Robert Smith: Just following that up, it may be something we should write to the SMMT about. In some sectors now, the main contractor, the vehicle manufacturer, in this case, covers their currency risk by passing it down the supply chain. Are you aware how much it is that manufacturers require their suppliers to invoice in euros, or is the hedging done in another way?

Mr Hart: To be honest, I am not aware of it. Some companies, GM, I think, operate in euros, whether that is all the way down the supply chain, Ford operate in dollars. I do not know what that tells you.

Sir Robert Smith: We will write to SMMT on this maybe.

Q76 Judy Mallaber: In your submission you mention the role of public procurement in aiding the commercial vehicle sector, and you will have heard the exchange earlier between Lindsay and the SMMT. Can you elaborate on what you are arguing for?

Mr Hart: It is curious. In the defence sector there is very major defence procurement going on currently, in terms of support vehicles for the Ministry of

Defence. I do not know how these things work, but clearly all the companies that are going for it think that there is an important role in showing that you have domestic production, because in all their lobbying activity they show that it is very important. We believe that is very important, and indeed, on this particular one, we believe that the project that would link up with LDV, in the Midlands, would be particularly helpful, in terms of securing, in part, the future of LDV into which the Government has put money previously. The particular bid which supports LDV, we think, is a good bid and should be supported. That is an important one on procurement in the defence industry. I think that what is good for the defence industry and the Ministry of Defence surely ought to be good in other sectors of the economy. It seems entirely reasonable to me that, in Dagenham, the police force always had Fords. I do not know what they buy now, to be honest, because it is a problem, maybe it is Jaguars, which probably has gone down very well because it is kept in the family. In Luton, the police force always had Vauxhalls, and that seems a natural thing, to support your local economy. It is absolutely right that, in terms of foreign countries that you go to, there is local procurement, it does seem entirely reasonable. I think that can be taken a lot further. For example, buses. Buses are not bought by Government, obviously, but certainly in London and elsewhere Government has a major role in bus procurement, in terms of regulatory frameworks and specifying, and so on. Why should not local government, or, for example, in London, the Mayor, take a view about the procurement of buses? London has the biggest market in buses. To take that on further, for example, London is testing three fuel cell buses, Mercedes Benz fuel cell buses. Why should not local government say, "Yes, we do want zero emission vehicles, very low emission vehicles, we do want fuel cell vehicles, and, in partnership with company X, Y or Z, we will support you in building fuel cell buses." Britain then could have the technological lead, and so on, in that particular technology. In London already, on that particular example, we have one of the world's biggest diesel manufacturing sites, in Dagenham. Why should we not move that on to starting off on fuel cells, why should we not have that kind of public procurement role?

Q77 Judy Mallaber: Basically, do you expect the public sector to buy British, is that what your expectation is, because the counter argument which SMMT and others would put is that we should not be protectionist in that way and that, overall, longer term, that would damage our competitiveness and our ability to trade? What are your expectations of the public sector?

Mr Hart: You can read books about perfect competition and it will be fine, that works if everybody else is playing the same game and there is perfect competition everywhere. However, if there is not perfect competition anywhere else apart from here, what that means is simply you cede territory to everybody else who is not playing perfect competition. I think it should be a factor. Nobody would say that the public sector, or Government, should buy duff vehicles that are overpriced, but working in partnership with different manufacturers to promote local production, to promote the highest quality research and development translating to production, that seems entirely reasonable. It should be a factor, I think, because it is a factor everywhere else in the world.

Q78 Sir Robert Smith: How would you get round the European regulations to require them to tender openly and not use public money to subsidise?

Mr Hart: I think we should stick to the European rules, the same way every other country does in Europe.

Q79 Linda Perham: I have just bought a new Nissan Almeira. That car was made in probably the most productive plant in the country, in Sunderland, so they are jobs which British people have got. The fact that it is a Japanese manufacturer should not make any difference to me buying that car, I would have thought. I was not thinking, "Oh, dear, I'm buying a Japanese car." Lots of cars and components are not made in this country, they are imported, and we export to other countries. From the point of view of supporting local economies, I think, in the last few years, perhaps in the last couple of decades, the thinking has changed from "You must all support MG-Rover, a known British marque, and not think about buying other cars, as a point of supporting your own country and thinking about jobs which exist, and perhaps could be increased, in this country." Do you think that is a fair point, or not?

Mr Hart: It is a problem for Britain. Only two out of the top ten best-selling cars are manufactured in Britain. I think that is a problem for the British manufacturing industry and the British motor industry. I am not talking about pure British marques, here I am talking about public procurement, I am talking about looking at manufacture in Britain. It seems entirely reasonable to me that British manufacturing should have some preference, some relationship with Government. Government does support manufacturing in all sorts of ways, so I do not have a problem with that. I cannot see why anybody would have a problem with some support for British manufacturing. I think it is a problem that there is a balance of trade deficit in the motor industry of £11 billion, and I think we ought to be working to reduce that balance of trade deficit.

Q80 Mr Hoyle: I think you are absolutely right, and we had the strange answer before, from representatives of the motor manufacturers, which seemed rather odd. If we take one of the unusual examples, of a Chief Constable who does not have his car tendered for but he has a price range from which to choose. If he goes out and chooses a Mercedes, it does nothing for any British jobs here. What worries me is that what we have seen is, and it was not really answered before, that fleet vehicles, say, police vans, we have got Southampton down the road, which I believe is one of the finest vehicles on the road, and yet Mercedes will come along and persuade them to buy Mercedes, on the grounds that the resale value is higher because they will take them back off them. It is loopholes like that in order to take the market share, and it seems very strange that their playing-fields would not even let you through the door, even to tender for any of their contracts, and it is that which we have got to address. I believe firmly that British taxpayers' money ought to go to supporting British jobs, because, at the end of the day, the only way the economy can continue is if people are employed. I think the danger is, if you allow it to continue it would be foolish, and I just wonder if you agree with that thinking?

Mr Hart: I think, largely so. I think we have got a European industry, and one should be careful because we make engines for cars which are made abroad, and so on, and it is a sophisticated industry, so one has to have some appreciation of that. Equally, it seems to me that it is right that British jobs—jobs in this country—should be supported in a variety of ways, whether it is active Government which supports British plants, in the same way as, for example, free marketeer Berlusconi, in Italy, when Fiat comes under some threat, will shout from the rooftops in favour of Fiat. Can you imagine France dispensing with Renault, Peugeot or Citroën? Of course not. Britain should be shouting from the rooftops, actively saying that we want our industry here and have a degree of preference and support for jobs, highly efficient British workers, making British cars in this country.

Q81 Sir Robert Smith: One crucial thing is to make sure that, any public sector organisation which is producing and putting out anything for tender, there is nothing in the requirements for the tender which will act as an unnecessary barrier to British manufacturing?

Mr Hart: Absolutely, yes.

Q82 Chairman: Have you done any research on how significant a purchasing policy of this nature would be, either in terms of the number of vehicles bought, the number of jobs saved or the degree of assistance that would give to the company? We can spend a lot of time on that kind of rhetoric, that is understandable.

Mr Hart: I accept what has been said and I think there should be, as I have said. However, I do not think we should overstress this. Far more important to us is, when there are plants under threat, when there are problems, that the DTI and Government, at Prime Ministerial level, see it as absolutely critical to keep plants in Britain. Put bluntly, the DTI up to 1997 had a view of no intervention under any circumstances, no touch, light touch, or whatever. Since then there has been much more involvement, but we are not there yet, in my view, of where there should be what I would call active government, shouting from the rooftops, as I say, and pressing and looking senior executives in the eye and saying, "If you want to sell in this country, you've got a duty to produce in this country," and so on. I think there is role for that. It works in other countries and I think this is how it should be. Just to clarify that point, because I see some puzzled faces—much of the industry recognises that if they wish to have big sales in a country it is critical they have a manufacturing footprint. That is what industry leaders recognise. The question is, how big is that manufacturing footprint? There is room for pressure on those sorts of issues.

Q83 Richard Burden: As a way of safeguarding and nurturing the industry in the UK, you probably heard, there was some discussion earlier on with the SMMT about the importance of the active involvement of Government and the industry, things like fuel cell technology and low carbon vehicles, and so on. Are you confident that enough is being done in those areas?

Mr Hart: No. I think the fuel cell is a fascinating case, and I hope there will be a sad case study of the relationship with science, technology and industry. The fuel cell was developed scientifically in Britain, the early development of it was actually at the Central Electricity Research Laboratories in Leatherhead, within nationalised industries. That was where the scientific work was done for the fuel cell which went on the first Apollo mission. We had the early science of it. Even since, we have been slipping away, in terms of technological development. The most recent developments on the fuel cell have come from Government intervention, but not in this country. Paradoxically, and surprisingly, it is from American Government intervention that some of the development has come, in particular, zero emission vehicles in California, which led to various partnerships, unlikely partnerships, of General Motors, Ford and others, and with, in particular, Ballards being the beneficiary, who are doing some of the most recent work on fuel cell development. Government intervention is what has propelled it. In this country, yes, the Foresight Programme, there is a lot of good work going on, but it seems to me to be taking work forward but not making the leap that will come from substantial Government intervention somewhere. Put bluntly, emission controls would never happen without harsh regulation. The catalytic converter would not have come from the industry, they are quite happy not to have it, but when there is harsh regulation the industry gets there. I think it is the same on fuel cells. Fiddling around the edges, being ready to move in fast within five to eight years, when there is a requirement for zero emission, is where the industry is. The question is, which Government, whether it is at European level or city level, is brave enough to push fuel cells fast enough, and which country is prepared then to develop that into a partnership? The first in will be the one with the leadership, and that is why I say, no, maybe London would be, and the Mayor has done things in London, or it may be Birmingham, or whatever, where there are elements of the industry, could be the first with developing the technology, and it will come first, and probably in buses, or CVs and then follow on. Remember, fuel cells is not just about propulsion, because of the nature of it, it transforms completely the nature of the vehicle, the whole floor pans versus top hats, as it is at the moment, transforms because of the weight, and so on. It will be a completely transformed industry, it will be far more plastic and everything will change, but the first in there will have the advantage, and there will be entirely new plants in the industry. The question is, is it going to be 2012, 2015 or 2025? My view is, for what it is worth, that it will come, without a doubt, unless some technology that we are not aware of comes along, but, the question is, when and where, and can Government go a lot beyond the Foresight Programme, which is good stuff but is still only a bit—

Q84 Richard Burden: What more do you think Government should be doing, precisely? If I was sitting here, as Government, and said, "Okay, I will intervene as much as you like to make the leap you're talking about," what does it mean actually, in terms of developing that technology in the UK?
Mr Hart: I think probably it will be linked with low emissions and congestion charging in more than one city and saying, "This is going to happen, and therefore you will—

Q85 Richard Burden: We are talking about intervention in terms of regulation and being demand-led?
Mr Hart: On the one hand, partnership with the companies in developing specific vehicles.

Q86 Richard Burden: What does it need to do in partnership with the companies that it is not doing?
Mr Hart: Sitting down with chief executives and saying, "This is going to happen, do you want to be part of it?" That is the way it happens in other parts of industry, in other sectors. Put bluntly, I think there is a role for that kind of serious partnership. "We want to do this, it is going to be good for Britain, it could be good for you. Do you want to be part of it?"

Q87 Richard Burden: I just cannot understand how that is different from when the Government sits down now and talks to industry about those things?
Mr Hart: Probably, on fuel cells and emissions, we are not making the leap. They are working, and there is very good work being done, R&D on fuel cells, and so on, but it is not going far enough, in my view.

Q88 Richard Burden: Could I take you on to the issue of skills. First of all, we have had a lot of evidence from a lot of quarters indicating that there is a problem for a number of companies in the sector, both recruiting and retaining suitably skilled and qualified staff. Do you agree with that, and, again, do you think the efforts which are being made to address that, such as the Automotive Academy, etc., are the right kinds of things to be doing?
Mr Hart: I could comment that the problem our members tend to face is that they have got skills and they are being made redundant, which is a problem. Skilled people, when they leave the industry, they are made redundant, often they are not brought back into the industry. There are skills issues and a whole number of others. Upskilling is very important. We participate in partnership and a lot of the developments are quite positive, in terms of people with the lower skills levels in production technology, and so on. With highly skilled people, I think there are areas of shortage. The Automotive Academy we participate in and it does seem to be very helpful. There are other measures around that we should not neglect. SMMT did not mention it but, for example, I know that Ford place a lot of stress on the fact that, in the main, they have addressed historically only 50% of the population. They are working for diversity measures, and the Dunton R&D Centre has introduced a crèche, and retaining women employees and attracting women into skilled roles has become quite an important thing to do. Family-friendly policies retain people a lot more. Clearly, we need more on skills. The Learning and Skills Councils are doing a lot, but it is not an absolutely critical problem, in our view, in quite the same way as some of the key problems of retaining jobs in the industry.

Q89 Linda Perham: The ending of the block exemption, you mention in your submission that it would be an issue at the Ford Daventry plant, but would you like to comment on that?
Mr Hart: Daventry is the warehousing plant for Ford dealerships, where Ford-branded products go, so, clearly, with the next phase, potentially, that is a problem, if the Ford-branded dealerships lose market share and there is a grey market, or whatever, that is a problem. Block exemption, one should not exaggerate the difficulties but certainly there are potential difficulties for the existing workforce in existing dealerships, and, in our view, that could translate into problems also for consumers, if you get lower quality work being done and if the regulatory environment is not precisely right. There are problems around but I would not like to exaggerate, but Ford Daventry, in particular, could face some problems.

Q90 Linda Perham: Perhaps it is too soon to tell, long term, what the ending of the block exemption would mean for the industry as a whole?
Mr Hart: Yes, I think it is. It cannot assist the industry, in our view. There may be some areas in which a consumer will do better, in other areas they may lose servicing, in more isolated areas. There are difficulties ahead and time will tell.

Q91 Chairman: What is the level of recruitment in the servicing side of the motorcar industry, union membership in servicing?
Mr Hart: It is not very high. We have a relationship with the motor vehicle retail repair industry, it is one of the biggest collective agreements. We negotiate basic terms and conditions with the motor vehicle retail repair, the Retail Motor Industry Federation body, but the membership is not enormous, although we are making a lot of progress. For example, because of the union recognition

legislation, we achieved recognition with Kwik-Fit, and now we have a very positive relationship with Kwik-Fit, which is a very good organisation in terms of training, and stands to gain, ironically, from some of the block exemption changes. It is a sort of reconfiguration of the industry. It is an area in which there is a lot of union membership growth, at the moment, in fact.

Q92 Chairman: I was asking because one gets the impression, and it is understandable, that, in part, at least, you answer the questions through the perspective of those areas where your membership could be affected, although it need not mean necessarily that there was a reduction in employment, *per se*?

Mr Hart: We would never do that, we have a broad view. Interestingly, one of the approaches to block exemption has been Mercedes, who had bought up their dealerships, and there are many issues with that, and we do have a relationship with Mercedes in a number of areas. Because they are directly employed by Mercedes, the bulk of the dealerships now, it is a different structure, in terms of trade union organisation and the relationship with the company and conditions and skills training, and so on.

Q93 Mr Hoyle: Is the truth of the matter that block exemption in the servicing of cars will mean that the companies will retain it because cars have become so sophisticated that small people could not set up to service these cars, in fact, the cars are designed actually to be serviced in-house, rather than allowing anybody else even to begin to compete?

Mr Hart: I think, in many areas, that is going to be the case in servicing diagnostics. I think, in some cases, the diagnostics is done by computers in Germany, so I think it is very sophisticated. However, we do not know, will there be some dealerships which will grow up which will service everything and approach it in a very different way? We simply do not know how it might develop and it is an industry in which there are a lot of misconceptions. It is dominated by a very few companies, which do not appear on the boards, but the Pendragons of this world, and so on, European Motor Holdings, own large numbers of dealerships which are not necessarily across company. Who knows how it will develop. It is going to be interesting to see, some good things for the consumer and some dangers and some good things for the industry and some bad things.

Q94 Richard Burden: The RDAs are an instrument of intervention. How effective are they in supporting the sector, in your experience?

Mr Hart: I agree entirely with the points made earlier about inward investment. The onset of the RDAs meant, in areas other than Wales and Scotland, there has been now a very coherent offer, in terms of inward investment, but I think also it is competitive, which is not a good idea.

Q95 Richard Burden: You mean, RDAs competing against each other for inward investment?

Mr Hart: Yes, for inward investment. There is a lot of good work being done. For example, there are centres of manufacturing excellence being established round the country, and Dagenham has got a beautiful, architect-designed centre of manufacturing excellence. That is a good thing and it is doing very good work, with linkages with higher education. The bad thing is that it is instead of an assembly plant and you can see the dust pile of the old assembly plant from the CME centre. We should not knock that work, and it is important in diffusing lean methods and all that stuff that is going on, it is good stuff but we do not want to exaggerate it either, its impact on an industry that is as big and ruthless and powerful as the motor industry. The RDAs are helpful but could be much better funded, we could have more regional assistance than is available, we use far less regional assistance than Germany, for example, in this country. I think they have begun but we need to build on that and fund it more, and so on.

Q96 Richard Burden: If the RDAs had more funding, what would you see as the main areas in which they could deploy those resources, what kinds of things should be done by them as opposed to being done by other arms of Government, in a sense, I suppose?

Mr Hart: One of the areas every RDA is looking at is clustering, and so on, clustering networking, and I think we have got room for work around that. If clustering is seen to be quite important in smaller manufacturing then certainly it is an area that they could play a major part in, plus coupling that with Learning and Skills Councils, the training that is appropriate to that. Diffusing technology to the lower tiers in the supply chain as well is a role they can play to ensure that there is a good offer to the manufacturers to sustain the big companies.

Q97 Linda Perham: Do you think the expansion of the European Union eastwards will have an effect on the UK automotive industry?

Mr Hart: I think it is an opportunity and a threat, to use the jargon, is it not? It is interesting, in *Automotive News,* which is the European trade journal, only quite recently, they have started enumerating the sales figures in Central Europe as well as Western Europe, it is seen as a market which is linking into the Western European market now. It is a bigger market. There is some production which is exported into Western Europe. Skoda is probably the only big one, but General Motors has exports, the Aguila, which is a Suzuki original vehicle, and certainly they have got some very competitive plants. Also, in terms of a kind of local Eastern European market, it is a place where the big multinationals squeeze extra value out of cars, so the classic Escort was built there, the classic Astra will be built there. In other words, the last Astra when the new ones come out in Western Europe, the cheap and cheerful car. That is getting more money out of a design, more money out of a platform. That is a bigger market for Europe as a whole and it is quite useful. On the other hand, it is a major competitive pressure. I think, in fact, that we have a role, as trade unions, in that we believe that the living standards and the wages probably will rise quite rapidly. I have been involved with the General Motors European Works Council for some time, the Polish trade unions have been on that, and clearly we will be looking to make sure that there is not intra-plant competition there. That will change, but it is still significant competitive pressure. The components industry is the area where, at the moment, there seems to be the most direct threat of moving sites eastwards, and I think it is a difficult area. It is going to be a question of whether the increasing production increases total European sales faster than Eastern Europe increases its production itself, so it is going to be a difficult one. We have got to keep a close watch on it in order that we do not lose production, lose jobs from here to there.

Chairman: I think we have just about covered all the areas we wanted to, Mr Hart. Thank you very much, that was very helpful. It is very useful to get your point of view. Thank you.

Tuesday 30 March 2004

Members present:

Mr Martin O'Neill, in the Chair

Richard Burden	Mr Lindsay Hoyle
Mr Michael Clapham	Judy Mallaber
Mr Jonathan Djanogly	Linda Perham
Mr Nigel Evans	Sir Robert Smith

Witnesses: **Dr Bryan Jackson OBE,** Managing Director, Toyota Motor Manufacturing (UK) Limited, **Mr Paul Philpott,** Commercial Director, Toyota (GB) PLC, and **Mr Mike Hawes,** Head of External Affairs, Toyota Motor Europe, examined.

Q98 Chairman: Good afternoon, Dr Jackson. We are very pleased to see you. I think that you will be aware that we are having this inquiry because it is about four years since we last looked at the automotive industry. In the intervening period a number of things have happened. Some things that we expected to happen; and other things that other people wanted to happen still have not happened either. The real intention today is to try and assess the state of the automotive industry in the UK. Obviously, as one of the major foreign players and one of the companies which is now well established in the UK, it is only fair to invite you, in the light of your collective experience. What do you see as the main strengths of the UK as a venue for automotive production?
Dr Jackson: Much of what we found when we first came here 14 years ago still exists today. It is fundamentally a stable economy; a long history and tradition of motor manufacturing and parts and component supply; a good workforce with a good work ethic; and an opportunity to manufacture and export into Europe. Also back then there were a number of issues that we now face, namely some of the regulations that we now face have changed. In the main, however, still a good place to operate. We have grown consistently over those 14 years, from very small to, now, a quarter of a million vehicles. We are currently examining ways of increasing that volume in the UK. So our commitment to the UK is pretty strong, and based on those fundamentals.

Q99 Chairman: What you are really telling us then is that the strengths you identified when you first came here have not diminished to any appreciable extent?
Dr Jackson: In the main, they are still there. There are some issues that have changed that do impact on us. One is in the educational field; one is in the supply field, which is changing; and some of the regulation that we now face has put an additional challenge, shall we say, rather than burden on us.

Q100 Chairman: The education—are you talking about the output from schools or from universities?
Dr Jackson: Primarily from university. We recruit and we have been expanding our workforce. We do find among 21 to 25 year-olds a falling-off in standards of the basics. We do not really mind what skills or knowledge they bring into the company, because we will be training them anyway; but the basic English, the ability to communicate, the ability to interrelate with other people, and basic mathematics have dropped off. That is clear.
Chairman: We may well return to these issues in a little while.

Q101 Mr Djanogly: It is generally acknowledged that there is global over-capacity in car production at the moment. Despite this, UK manufacturers seem to be increasing output. Do you think that that is sustainable?
Dr Jackson: It is how you define 'over-capacity'. There are certain companies who would say that they have over-capacity. In our case at the moment we have under-capacity. It is a very complex problem. It is how much you use your equipment; how you operate. It is the type of vehicle you are selling; the type of market you are selling into. If you take a broad brush, therefore, you could say there is over-capacity, but within that there is under- and over-capacity. In our case it is under-capacity. We are looking at ways of increasing our volume.

Q102 Mr Djanogly: So you see growing capacity in Europe?
Dr Jackson: Again, it depends on the vehicle and the market in which you are selling. In our case, we manufacture Avensis and Corolla. Sales of Toyotas in Europe have increased 11 consecutive years, and we are setting sales records every year. We see an opportunity, because the customer at the moment likes the product and we seem to be meeting the needs of the customer—which is what it is all about. As such, we are the sole manufacturer of Avensis and we, among others, supply the Corolla to the European market. Clearly we cannot satisfy the sales companies at the moment. From our perspective, therefore—and I can only speak from our perspective—we see an opportunity to expand.

Q103 Mr Djanogly: So, apart from increasing market share, you see the market increasing in Europe?
Dr Jackson: Again, how do you define "Europe"? With Eastern Europe opening up, Russia—yes, there is great opportunity. Then, for Toyota globally, you have Asia and the southern continents. So there is a lot of opportunity.

Q104 Mr Djanogly: I know that another colleague will ask you about eastern Europe a little later on, so perhaps we could stick to western Europe. How do you see the market changing in western Europe over the next 10 years?
Dr Jackson: Primarily it will probably change in the type of engine—so between petrol and diesel. There is a big swing and diesel is increasing year on year. In terms of the market itself, probably hovering round its current level. I do not think it will expand much greater; but, again, there are always opportunities to create new markets. You can bring in a sub-compact; you can bring in a different type of vehicle; five or six years ago it was SUVs. So it is changing all the time. It is challenging, but I think that it is a great opportunity.

Q105 Sir Robert Smith: In your submission you mentioned the problems of the historic strength of sterling against European currencies. Do you have a view on whether it would be beneficial for the UK to join the Euro?
Dr Jackson: We have always said that we had an exchange rate problem rather than a Euro problem. The Euro would give stability in business planning and any risk you take out of business planning has to be good for business. Equally, however, we know that this is a sensitive issue. What we have therefore tried to do is control the controllables. We have taken a lot of cost out of our business and we have tried to maximise our volume. We call it our survival plan, because we were haemorrhaging money, and that had to stop. We have been successful in that, and we have introduced two new models. The Corolla and the Avensis are new and they are very successful in the market. We have had to do what we have had to do, rather than rely on somebody else trying to sort out our problems.

Q106 Sir Robert Smith: From this base, are you mainly trading into, first, the UK market and, secondly, a Euro currency market? Or do you benefit from trading into other currency markets?
Dr Jackson: 20% of what we manufacture is sold in the UK; 80% is sold into mainland Europe. It is probably about 75% into mainland Europe; there is 5% that goes to another 100-odd countries around the world for marketing reasons, but primarily Europe.

Q107 Sir Robert Smith: Requiring a supply chain to bill in euros—what sort of percentage does that mean you are exposed to the currency, or how much do you pass on to your supply chain?
Dr Jackson: We still have an exposure to the euro—buying parts versus selling the vehicle. What we have done over the last two years is to minimise that greatly. We have therefore minimised our risk. It is part of our survival plan.

Q108 Sir Robert Smith: But the supply chain has taken on the risk?
Dr Jackson: No, we did not stipulate to the supply chain what was the exchange rate: they quoted in euros. They were therefore able to make their own decision on what was competitive. Equally, we work very closely with our suppliers. We therefore have the opportunity of working with them to introduce the Toyota Production System. We are heavy supporters of the Industry Forum. In fact, if I can make a request, please ask the Government to continue their support of the Industry Forum. I think that there is a huge benefit to that. We work with our suppliers, taking cost out, not negotiating price down.

Q109 Mr Evans: You spoke about Eastern Europe opening up, and I am not sure what constitutes Europe these days. However, where we have these 10 countries now acceding to the European Union, what impact do you think that will have generally on the whole gamut of car manufacture?
Dr Jackson: Certainly in places like Poland. We have moved to Poland. We are now building a new plant in Poland; we have an engine plant there, a transmission plant there. We are also going into the Czech Republic, and there is a Joint Venture with PSA. I think that it follows our philosophy of manufacturing the vehicle close to the market in which it is sold. So, with eastern Europe opening up, it is quite natural. I do not think that it is an economic, "Britain is a bad place to do business. Let's build in Poland". It is natural that we would go close to the market and this is the market. For Toyota, therefore, there are huge opportunities. For Toyota UK, it is a challenge, because we have to compete globally. We have to win new business. We did not win, as an example, the new diesel engine. That has gone to Poland. We cannot relax, therefore. We have to be competitive and we have to be able to convince the shareholder that we are the right place to invest. So we are not complacent about our position.

Q110 Mr Evans: It is too easy to say that eastern Europe, and particularly Poland, is a threat and an opportunity; but do you see it more as a threat on the manufacturing side?
Dr Jackson: To Toyota UK?

Q111 Mr Evans: Yes.
Dr Jackson: Yes, you could see it as a threat, but I would rather see it as an opportunity, because what it makes us do is look at how we operate; to say, "Can we take more cost down? Can we improve our performance? Can we become more productive?". In other words, we should look upon it positively, not negatively. That said, we can only do so much. We can only control what we can control. So we have to be careful that we are not getting an un-level playing field by having this charge to regulation very quickly. Individually, I have no truck with anything that the Government has done. If you take the regulations individually, they are sensible and very much in line with our philosophy of how we operate—our ethics. The analogy I use is that it is like a brick: I can pick up a brick, examine it and say, "How am I going to use this?"; but when they come one after the other, it is a wall and now I have got to get over this wall. That is much more difficult. We

have to understand that there has to be a balance. We are not saying do not introduce regulations from Europe. That is nonsense: we have to. We should not gold-plate them, however. We should not rush to be first. There are a number of examples recently that have been quite alarming.

Q112 Mr Evans: Have you looked at some of the regulations that the Polish particularly will have to follow? I do not know if they have had any derogations when they come into the EU. You also mention gold-plating. Can you give us any examples of things that affect your industry?
Dr Jackson: I have not looked at the Polish thing, but I know that when I visit the Poland plant the atmosphere and attitude there of how manufacturing is seen is different to the UK Government. Very welcoming, warm, supportive—"Anything you want, we can supply. We want you here". It is almost blatant. In terms of gold-plating, this is perhaps not a very good example of gold-plating, but it speaks to the rushing. We have EU Emissions Trading coming in and we are rushing, as a country, to implement this. The application of it is not fair; it is not a level playing field. It encourages companies who are removing production rather than increasing production. Basically, we will rush ahead and introduce it. There is a massive cost to the industry. There is a cost to us. Then we hear—and it is only hearsay—that France will exclude the motor industry from it. Within the United Kingdom itself it is so interpretable that some of our competitors are in and some are not. So it is all a bit of a mis-mash. However, we are charging ahead and everybody else is backing off, saying, "We will just relax and wait and see". We are not saying do not introduce it, but we are asking why be first? For once, let us relax a bit, step back, see what our competitors do—because they are competitors—see what our competitor countries do, and then introduce a sensible, workable, fair and equitable process. We make mistakes when we tend to rush. We do as well, as a business. It is better to step back and think it through.

Q113 Mr Clapham: Dr Jackson, it is predicted that the growth for cars will be in Asia. Given that fact, do you feel that there is a threat that companies may refocus to be nearer to those markets?
Dr Jackson: I do not think there is a threat. Toyota has already established itself in China, India, Bangladesh, and has a number of joint ventures. Basically, it is following its philosophy, as I said earlier, of building cars in the market in which they are sold. Primarily, the manufacturing plants there will service the market there. Quite the reverse: it could be a good opportunity, particularly for the parts and components industry, to help supply into those areas. So I see it as an opportunity. I do not see it as a threat to me; I see Europe as a threat to me.

Q114 Mr Clapham: So you see it as an opportunity for Toyota UK?
Dr Jackson: Not so much for us. As I say, we have a problem at the moment. We cannot satisfy the volume demands for Europe. So our attention is focussed primarily on that. For Toyota globally, a huge opportunity, yes.

Q115 Mr Clapham: Given that there will be a massive market out there, do you see any opportunities at all for the UK car industry, other than the components industry?
Dr Jackson: I cannot speak for the rest of the industry but, as an observer of the industry, I think that there has to be an opportunity, if you were going to make a very small, cheap car, I suppose. But I honestly believe that the market will grow sufficiently in Asia that whatever is made in Asia will be sold in Asia. I think that you have to be in the market. You cannot ignore it. The big players have been there for a while, so it is not new to us. However, it is too big a market to ignore.

Q116 Linda Perham: You mentioned joint ventures, Dr Jackson. We have increasingly heard of companies being involved in joint ventures. What are the benefits of that?
Dr Jackson: Basically, you are spreading your costs. A lot of our joint ventures are in research and development into future technologies, and it is wise to share the burden of that cost. We do have joint ventures in terms of manufacturing. The longest JV we have had is with GM in the US. Toyota's first venture into the US was with GM. That was a mutual agreement, because GM got the benefit of the Toyota Production System and Toyota learnt about manufacturing and operating in the States. Since then, it is mainly economies of scale—like our joint venture with PSA in the Czech Republic to make a very small car. It makes sense to share the costs.

Q117 Linda Perham: Are there countries where you could not operate unless you were in a JV? The Committee went to China about 18 months ago and there were, not the automotive industry in particular but other industries where companies could not operate unless they had a JV. Is that the case in the Far East?
Dr Jackson: Not to my knowledge. I know that in China it is very much the process, but I am not familiar with the rest of the arrangements. I can understand why it makes sense. If I were the Chinese Government, I would want to get involved; I would want to learn; I would want to generate an indigenous industry. It is common sense to do it.

Q118 Judy Mallaber: You have said in your evidence that you have always tried to use UK-based suppliers and have given the positive reasons for that, but also that the UK component, as with other companies, has fallen. Can you say a bit more about the reasons for that and what you may have tried to do to maintain that base in the UK?
Dr Jackson: We used to be about 60:40; we are about 50:50 now in terms of the UK/European supply base. There is a mixture of reasons why that has

come about. Obviously suppliers faced exactly the same challenges as we did, so they have made business decisions to move to mainland Europe and, indeed, not necessarily to Euroland but outside Euroland as well. That is self-generated, therefore. Also, they cannot compete any more on price alone. There is quality, R&D, development and innovation. It is a sweeping generalisation to say that Britain is bad and mainland Europe is good, because that is not the case. The good suppliers have been able to compete, compete competitively, and still retain the business. The not-so-good have lost business; but that applies to any business, I think. So it is a mixture of competitiveness and making decisions on their own particular future development as a business that has made them move off the UK to mainland Europe.

Q119 Judy Mallaber: You also have a line in your evidence saying that there is still a lower level of quality from European suppliers, including the UK, compared with Japanese suppliers. Can you break that down for us at all? Where does that lack of quality come forward and what are they falling behind on?
Dr Jackson: The first thing is quality of R&D. Perhaps I can explain the difference. When I was in Japan dealing with Japanese suppliers, they had the drawing but they would come and say, "We have looked at this. We can do this, this and this. It is the same performance. It is a better quality. We can make it for a couple of yen less", and they would develop it. In the UK and in Europe it is very much, "Here is the drawing" and "I have made it to the drawing". There is a huge difference in approach and attitude. However, I think that stems from having a 20 or 30-year relationship. "I can trust you. I have dealt with you for 30 years. If you are going to make a change to the drawing, I will trust you." Again, it is not black and white. In terms of quality of component, the component that goes on the vehicle is no different to a Japanese component. Otherwise, we would not use it. The process of getting there, however, is very different. The reject and scrap rate will be a lot higher than a Japanese supplier and you have to work harder at getting to the quality level; but the quality that goes on the vehicle has to be the same.

Q120 Judy Mallaber: Are you taking any action to try to improve the productivity, the ease of dealing with, or the quality of the UK-based suppliers?
Dr Jackson: Yes. Within our purchasing division we have a department that is responsible for working with the supplier to improve quality. Basically we do it by working with the supplier to produce the Toyota Production System. We have a dedicated team of TPS experts who will go and work with the supplier. That is our input, and we work with 25 or 30 major suppliers, doing that. We also support the Industry Forum, which works with the first and second-tier supplier, and we have supported that with manpower. We brought our experts from Japan right at the start, together with other colleagues, and worked in establishing it and generating all the training programmes. So now we have British-trained engineers applying the efficiency improvements through the Industry Forum.

Q121 Judy Mallaber: Can I move back to the question of regulations? That is obviously a subject of some concern to you, and you have expressed concerns separately to my constituency as a local car company. It is claimed that the UK is more rigorous in its application of EU regulations, and you have said that earlier. I know that you are particularly concerned about the Emissions Trading Scheme, which you referred to earlier. In other areas in your evidence, however, you also talk of places where the UK has not opted, and you are asking us not to go along with provisions on temporary staff and to keep the opt-out on the Working Time Directive. I wonder if you can give us a picture overall on how you see our commitment to new regulations and how it affects the company?
Dr Jackson: A lot of it tends to be anecdotal, does it not, about the gold-plating and what-have-you? Again, if you look at everything that has come in the last five years, it is not so much the regulation itself; it is the application. I do not think sufficient study is made of the cost implications. It is the cost of introduction, the cost of administration, and the cost of application. Perhaps I may give an example. We had the climate change levy, and we have to submit for a rebate. Yesterday, the senior engineer in charge of environment spent four and a half hours with Customs and Excise, going through our submission line by line, to make sure that we were claiming correctly. I would rather that he spent four and a half hours reducing the emissions coming out of my plant, not on paperwork. Point one is the hidden costs of what we do in terms of introducing regulation. You specifically raise two issues which we have referred to in our submission. We have, in our agreement with our trade union, the statement "to provide long-term, stable employment". That is a contract balance. We need flexibility because our business is cyclical. When we are introducing new vehicles or if volumes are changing, therefore, we need to be able to adapt very quickly to that. We need that flexibility. In terms of the opt-out, it is not a given. Nobody can be allowed to work more than 48 hours per week without the express permission of senior management in the company. We monitor and control it. We issue reports every month. It is the last resort to opt out. So we share the objective of the Working Time Directive. We do not want people working excessive hours. Within that, however, we know that our industry is not flat; it is cyclical. We need that flexibility. Otherwise we cannot deliver our commitment towards long-term, stable employment. So, yes, please retain the opt-out. We are way below the average number of percentage of people who do opt out in Europe, from the reports. Our control of it, in how we control the Working Time Directive, was cited by the CBI as an exemplar for the UK.

Q122 Judy Mallaber: There is also a suggestion that not only might there be a differential application of regulations between countries but that they are applied differently between companies within the same country. You refer to that again specifically on the Emissions Trading Scheme. Can you say a bit more about that?

Dr Jackson: It is based on the definition of what generates your power. I do not have hard evidence for this. However, this is a pretty incestuous industry, and we know everybody, because basically we all started in the same company—and we can find out. We find that some companies are being excluded; some people are being included. If, for example, you have one boiler that generates a certain wattage, you are in; if you have exactly the same but there are two and therefore they are half, you are not in—but the power generation is the same, and so on. We find that you will have one company that will be in, one company that will not be in. There is a cost. If you take ETS, we are in a situation where they have calculated it over the 1998–2002 average—but we have been expanding. We have been expanding, recruiting people, producing a higher volume, selling more vehicles abroad and earning money for the United Kingdom. Our target is set on the average. So if I had been declining and getting rid of people, I would have had a bigger allocation. Now I find myself in the position where, because I have been expanding, increasing the volume, and recruiting people, I now have to go and buy carbon. Who do I buy it from? I have to buy it from people who are declining but who have been allocated a huge amount more than we have. Not only that, we find that no account is taken of what we did from 1992, when we started, to 1998. We were the first car company in Europe to get ISO14001. We understand and are concerned about the environment. That is ignored. It is just these four years. Again, we have a target of such high proportion that the technology does not exist to achieve it at the moment. If you read the regulations, there is something in there which says that you should not have an unfair advantage to your competitor. You should not be asked to do things that are not physically possible—yet we are. That is an example of rushing into implementing, and not getting it right.

Chairman: You may care to drop us a line on that, because we are looking at Emissions Trading quite soon in another context. We are therefore happy to get a spectrum of experience of some of the problems which are being confronted.

Q123 Richard Burden: Could we move on to cleaner fuel technologies, cleaner engine technologies? In your evidence you say that there is something of a policy confusion in government, and the example of Powershift is mentioned, which was oversubscribed, and so on. What do you think that the Government should be doing to encourage cleaner fuel and cleaner engine technologies?

Mr Hawes: You refer to the grant programme, Powershift. Toyota has benefited from that programme over the past three or four years with the pre-assignment. That grant support has been very important in increasing acceptance for that new technology. To get a consumer to invest in new technology is a difficult process. However, I think that what the Government have now found is that, because there is a myriad of technologies coming to the market or coming forward, they need to look at how they manage those competing technologies. At the moment, Powershift identifies as worthy of support CNG, LPG and hybrid. What we would advocate is moving away from that technology-specific standard and towards a much more standards-based approach, where you establish a set standard. Any technology, within reason, that qualifies by those emission standards should then be eligible for some sort of grant. Even though we have benefited from the technology-specific approach in the past, we think it is time to change it.

Q124 Richard Burden: Would the standards in the scheme you are advocating be much the same, but they would not be technology-specific? For example, would you get to a situation where there could almost be a further incentive on diesel?

Mr Hawes: I think that you need to look at the basket of emissions. Clearly where the government policy is going forward is looking very much at CO_2. However, we also have to recognise that there are European emission standards for the other basket of regulated emissions—NO_X, particulate matter, amongst others. You have to look at the two in combination. What we would propose would be, to use a pun, some sort of hybrid which looks at balancing a CO_2 incentive as well as the stricter environmental air quality benefits which some of the newer technologies can also deliver.

Q125 Richard Burden: As well as there being an incentive to the customer to swap over to a cleaner form of technology when purchasing or after having purchased a car, are there things you think the Government should be doing, or indeed the industry should be doing, in terms of improving Britain's role in developing cleaner technologies themselves? Whether that be further work on diesel or whether it be pushing forward fuel cell technology.

Mr Hawes: Most of Toyota's research and development takes place outside of the UK. Obviously, because it is a Japanese company that tends to be focussed on Japan and our European headquarters in Belgium. I think that the Government are looking at ways of stimulating UK research and development. Certainly, as a UK-based company we would encourage that, through initiatives such as the Low-Carbon Vehicle Partnership. I think that is the right forum, because it has as one of its main missions to stimulate UK companies' involvement in these newer technologies. I understand that a centre of excellence for low-carbon technologies is just round the corner. I think that we will therefore begin to see the fruits of some of those deliberations. As a global company, we will look at the best in the world and, if a particular research and development stream is based in the UK, we are more than willing, as a global company, to enter into relationships with the UK-based organisations.

Q126 Richard Burden: Would you say that the kind of incentives, the kind of competitions, projects and so on, that the Low-Carbon Vehicle Partnership are adopting are the right ways of going about that, or are there other things that could be done?
Mr Hawes: I think that it is on the right track. It is only one year in. I think that it is a long-term process, and one of the major obstacles we have to overcome is getting consumer acceptance of some of these new technologies. People are still scared that they are investing in a Betamax rather than a VHS, to use an analogy. To overcome that, we have to raise people's awareness of the environment as a factor in the purchasing decision—which again will relate to cost. A lot of these technologies, including hybrids, have a slight price premium, which government mechanisms can help overcome. We must look at all these issues and find a way of raising awareness of these cleaner technologies and heightening consumers' acceptance of these new technologies.

Q127 Richard Burden: What about the use of advanced materials? We have been talking about fuel systems, engine systems. What about the use of lightweight and advanced materials? Have they got much to offer in the future or are they going to be too expensive for the mainstream automotive industry?
Mr Hawes: They have. Clearly the lightweight materials will help reduce the weight of the car and hence reduce the CO_2 performance. Clearly that will help all manufacturers meet their targets under the voluntary agreement with the European Commission. The problem comes when you have competing priorities. The examples you use—lightweight materials, things like carbon fibre—are less recyclable than some of the other existing materials. We have also to meet commitments under the End of Life Vehicles Directive, which will regulate the recyclability of our vehicles. As that target goes up, we need to make sure that we can achieve that. If we also face the competing target of reducing weight to reduce CO_2 with the introduction of these new materials, you can see quite quickly that we are at something of an impasse.

Q128 Mr Hoyle: We went to Singapore, where we were told that life expectancy of a car is no more than 10 years. Would you like to see that introduced in the UK?
Mr Philpott: I think the life expectancy right now of a Toyota is something nearer 12 or 13 years.

Q129 Mr Hoyle: Would you like a law passed that no car can be on the road over 10 years?
Mr Philpott: No.

Q130 Mr Hoyle: Can I take you to a question where I was not quite sure what the answer was. You spelt out that, regarding the Working Time Directive, you do not want the Government to sign up to it; you are happy with the situation as it is, and you made that very clear. Does that mean that your French factory is allowed to opt out or not? I presume that they must have signed up to the Working Time Directive.
Dr Jackson: Different volumes, different vehicles.

Q131 Mr Hoyle: Is that a yes or a no, just out of interest?
Dr Jackson: It is a no. I do not think they have opted out. I do not think they can opt out.

Q132 Mr Hoyle: Yes, they have signed up.
Dr Jackson: I honestly do not know. I would have to check.

Q133 Mr Hoyle: Could you let us have that, because it seems interesting that you put a very strong case, quite well put, convincing everybody why we should not be, but people might question it if your French factory has signed up to it. If we could have that information, I think that we could all benefit from it. Perhaps I can take you on to something completely different. Obviously the motorsport sector in the UK is very important and very strong. Do you have any interaction with the motorsport companies?
Dr Jackson: No. It is based in Germany and has been for a number of years. There is nothing that we do, other than go to the Grand Prix in July! Seriously, we have very little to do with it.

Q134 Mr Hoyle: Do you believe that we can get any benefits from the motor race industry?
Dr Jackson: Obviously what our engineers are developing and designing in the Formula 1 car—many such developments do find their way eventually into the mass-production car, but directly, no. We have very little involvement, as I say.

Q135 Mr Hoyle: So you do not believe that it gives you any competitive advantage by being in there?
Mr Philpott: On the sales side it adds a promotional dimension to our brand, and that has to be a positive.

Q136 Mr Hoyle: In terms of the research and development and technological advantage, however, there is nothing to be gained by coming out of that? You do it in-house in other ways.
Dr Jackson: Yes.

Q137 Mr Evans: On the back of one of Lindsay's other questions is the matter of France. Are you able to compare the productivity or profitability of the British plant versus the French plant?
Dr Jackson: No. It is almost meaningless, because the vehicle is so different; the manufacturing layout is very different in France. We kaizen every time, so it is a different layout. It is not something that we do. We would rather compare on quality.

Q138 Mr Evans: So there is no sort of league table of productivity or profitability?

Dr Jackson: No. There are companies and there are newspapers that do it, but it is a bit apples and pears, to be honest. The only thing I would say about the tables, and why I read them and pay any attention, is the relative position you are in. If it is an apple and a pear this year, as long as it is the same apple and pear—if you have moved, then it is relative. However, I pay very little attention to productivity figures that appear in such tables.

Q139 Mr Evans: So why do you think that we lost out to Poland then on the new investment?
Dr Jackson: It is cost. It is how much you can make it for.

Q140 Mr Evans: Which does not bode very well for the future, does it, if it is cost?
Dr Jackson: It is cost at the time. We know what are the issues. In terms of the car, it was not. That was because of the market. In the case of the diesel, however, it was cost. So cost of investing compared with cost of investing; cost of labour compared with cost of labour, and the decision was taken that it would go to Poland. As I said, what we now do is study and, if we cannot beat cost, then we will have to beat it on something else. Speed of delivery, quality of delivery. The quality would be the same, so there is no option there. There is a worldwide quality standard and we are audited by TMC—every company around the world. We cannot compete on pure quality, therefore. We have a plant in Turkey. Salaries there are much lower than our salaries. Regulatory burden? None. No Working Time Directive in Turkey. You can work as many hours as you like. They have really outstanding people coming out with engineering and science degrees, who work on the production line sometimes, not as engineers. So their education system is generating high-quality people, who are operating in such a situation. So, yes, it is a challenge—a huge challenge. Poland and the Czech Republic—the salaries there are 50%, something like that. Yes, it is a challenge.

Q141 Mr Evans: You can never compete with that, can you? You would not want to in any event.
Dr Jackson: No, impossible. What I do not want to do, however, is have the additional burdens added to the cost I have already got.

Q142 Mr Hoyle: I am amazed, because you said you could not compare the cost of the UK plant to the French plant, yet you can compare Turkey—
Dr Jackson: I did not say cost. I said productivity and—

Q143 Mr Hoyle: But it all comes down to cost at the end, does it not? Productivity is part of the cost.
Dr Jackson: Yes, but I do not make a Yaris. I make Avensis and Corollas, so comparing the cost of manufacture is very difficult. I make a diesel engine; they are making a diesel engine. It is very easy for me to compare the cost. I could compare the cost.

Q144 Mr Hoyle: That is what I am saying.
Dr Jackson: But there is no benefit. I am not going to be making the Yaris.

Q145 Mr Hoyle: Presumably, in the great Toyota structure, somewhere higher up the chain, somebody must compare cost, to make the decisions of the future.
Dr Jackson: Yes.

Q146 Mr Hoyle: I wonder if you could possibly get some of that information to share with the Committee in a letter. It would be very useful, to show the advantages or the disadvantages of the French factory.
Dr Jackson: Can you leave that with me?

Q147 Mr Hoyle: Of course I will, yes.
Dr Jackson: I am not so sure I want to be sharing the costs—
Mr Hoyle: That is why I said in writing, and not to show outside this room.

Q148 Mr Djanogly: When you have plants across Europe and Turkey, from Toyota Japan's point of view does currency come back into it again? In other words, does having a plant out of the Euro and in the Euro act as a hedge factor?
Dr Jackson: Maybe four or five years ago it was a factor, but now we have taken steps to address it and so it is not such a factor.

Q149 Mr Djanogly: Financial hedging?
Dr Jackson: No, we have just taken cost out, to handle any exchange rate fluctuation. So we can operate now at a better exchange rate than we could four years ago.

Q150 Mr Djanogly: You have passed on costs to other people?
Dr Jackson: No, we have not passed on costs to other people. We have reduced them. It is no good me bankrupting a supplier. I need the part.

Q151 Mr Djanogly: Yes, but the costs are so dramatically lower in Poland or Turkey, as you have just said. How much cost can you take out of England, comparatively?
Dr Jackson: We took 30% out on the new model.

Q152 Mr Djanogly: That makes an English factory competitive with a Turkish one?
Dr Jackson: Yes, absolutely. We have lost a lot of money. Our target this year is to break even. That is a huge turnaround. Everybody in the company has been committed to taking cost out, without damaging the quality of what we are doing because, again, that is short term and would not pay us any benefit long term.

Q153 Richard Burden: I will ask you a couple of questions about skills but, before I do so, could I take you back briefly to the comments you made regarding motorsport? You suggested that in this country you see it mainly as a marketing tool, rather

than anything particularly technological. Do you think that it is seen the same way in Germany? In other words, why did Toyota, when setting up a motorsport operation, talk to Germany rather than the UK, when, if you like, the motorsport industry is bigger in the UK?
Mr Philpott: Our Formula 1 team was set up in the factory where our previous rally sport team was set up.

Q154 Richard Burden: I was not meaning Formula 1 particularly; I was meaning the motorsport operation.
Mr Philpott: Okay, but that was the decision why it went to Germany. It was already an existing operation that has been expanded and built upon. It is difficult for us in the UK to comment on whether that gives different commercial opportunities to our German colleagues than it does to us. It was felt that, given that existing operation, there was a better access to the broad skills base that is needed to run a Formula 1 team.

Q155 Richard Burden: In relation to skills, the Automotive Academy has been established recently. Do you think that is structured in the right kind of way? Is it doing the right kinds of things? Is there anything else that could be done?
Dr Jackson: I should declare an interest. I sit on the board of the Automotive Academy. So, yes! Seriously, I think that the way we are going is the right way. I am very pleased that the Government are supporting it, and they should continue to support it. We have just started, basically. The next six months are very critical. We have to establish the programmes; we have to establish the credibility of the programmes. Under the chairmanship of Joe, who will be giving evidence later, I think that we will make this work. I think that it is a major element in up-skilling and increasing the performance of our industry in the UK. I would like to think that in—I do not know how many—10 or 20 years, if you are a fellow of the Academy, it will be seen as a worthwhile and "want to" qualification to work in the industry. We have the right mission, we have the vision, and we have the commitment to make it work. So, yes, I am very supportive.

Q156 Richard Burden: That is good to hear. Is there any more that you think should be done, whether through the Automotive Academy route or others, either by government or by the industry itself?
Dr Jackson: In terms of skills, not really. As a company, we will handle that. In terms of university, I hope that we do not price out students from the longer degrees of science and engineering. We should be finding a way to encourage people into those fields and we need to get them young. We have a role to play there, as part of the industry. Industry has a role. We cannot complain. We ought to go and do something about it. We have created young science clubs and young engineers' clubs in the local schools, where we get anybody from about nine to 13. We give them a project; they develop this engineering project; they come and present it to the board of directors, and we assess and give advice and guidance on this. We are very pleased to see the number of kids who are participating in this, both male and female. Yes, it is a drop in the ocean, but if we all start doing something like that it will sell to the child that there is something else other than being a lawyer—with no disrespect to those present.

Q157 Richard Burden: Most of us round the table would say amen to that, but not all! It is good that Toyota has taken that initiative, but do you find that in the places that it happens, the schools, they buy into that project? Do they promote that project by, say, the local Learning and Skills Councils, or is that patchy across the country?
Dr Jackson: No. We ran a pilot and then we were approached by schools to participate in it. It is like all things: schools are driven by personality. Some of the headmasters and headmistresses I have met personally are absolutely driven and committed, and want to make a difference. If you get a good head, the school buzzes; and they are innovative and prepared to try new things—certainly the head and the staff involved in the schools that we are working with. However, it is not all altruism. We benefit, because hopefully some will go on and work for us in the locality. The other benefit it gives us that it is run by our young graduate engineers. It gives them the opportunity to go out. I go into the school and it is, "Here's an old guy coming in to talk boring manufacturing". A 22 year-old engineer goes in and says, "I'm six years ahead of you and this is what I have done and this is what I am doing". Eyes pop, and they can identify with this guy. So it has been very good development for our young engineers. Everybody is benefiting from this process.

Q158 Richard Burden: You mention schools. What about LSCs?
Dr Jackson: We have had some discussion with them: not a great deal. I think that they tend to leave us to our own—they visit and see what we do. We have our own huge training centres. We say, "If you join Toyota, it is a training company. It is a lifelong training". We do keep abreast and we do keep close contact with the LSC and also with the RDA, because we do not operate in a vacuum. We are part of the community. We would like to think that we are a good corporate citizen, as they say. We try to participate and support, and we lend our name to many initiatives. The brand is powerful in such aspects.

Q159 Linda Perham: Can we have your views about the changes to the block exemption rules?
Mr Philpott: It is obviously early days still. Those companies distributing vehicles and parts have more commercial freedom. We have seen, in these early days, some consolidation in the retail industry that could work against the very increase in intra-brand competition that the Commission were trying to achieve. So we have seen some consolidation in the early days. Toyota argued consistently, through a positive dialogue with the Commission, that block exemption should be reassessed regularly. We have

30 March 2004 Toyota

taken that opportunity, through block exemption, to reassess our network, establish new standards, in order to deliver a better experience to the customer. Having established and redefined our dealer network with what we call a hub-and-spoke approach, we are giving operators greater opportunity, with bigger areas of responsibility, where they may have two or three outlets. Working with those operators, we are now driving up standards. The early signs from consumer surveys is that consumers are recognising that they are now being provided with a better service.

Q160 Linda Perham: What about independent garages? We have some evidence later from the Automotive Distributive Federation, and they are saying that independent garages are still having trouble identifying components for replacement. What about the approved servicing of your vehicles? Have the arrangements for that changed at all?
Mr Philpott: Yes, they have. Through the new block exemption, obviously the agreements for sales and service have been broken apart. We now have a separate service agreement. Indeed, we have around 20 authorised repairers set up who do not have the agreement to sell Toyotas, but they can service, maintain and supply parts for Toyotas.

Q161 Chairman: Perhaps I can raise one last question with you, Dr Jackson. You have given us a very optimistic picture, in the sense that you have said past performance has been improved year on year; that you have a mass production unit and you are producing two cars, the Avensis and the Corolla. Where are they in their lifespan as vehicles?
Dr Jackson: Avensis was launched last May, so in the first year, and the Corolla is two years out—so pretty new.

Q162 Chairman: The life of a car is what? Four years?
Dr Jackson: Four to five years.

Q163 Chairman: How long does it take to set up a replacement line for, let us say, the two year-old one? When would you have to start making the decisions about the replacement model and the line?
Dr Jackson: Probably two, three years ago.

Q164 Chairman: How many months do you expect it will take you to get to market?
Dr Jackson: A Corolla?

Q165 Chairman: Yes.
Dr Jackson: It varies, but 30 months, 35 months, but the decision has to be made. Depending again—we have to work with the supply base; we have to work with equipment manufacturers; and we have to determine how we are going to build it. Then we spend a lot of time. Our experimentation is before we sell it, not after we have sold it. So we do a lot of pre-production and development work.

Q166 Chairman: So where are you then with the model if, in two and a half years' time—
Dr Jackson: I realise that I have some of my competitors sitting behind me, so can I just—

Q167 Chairman: You do not have to be unduly frank. What I am trying to get at is—
Dr Jackson: I am not worried about the future five or six years, if that is behind your question.

Q168 Chairman: You would anticipate having a replacement in time?
Dr Jackson: For both.

Q169 Chairman: These decisions are taken where? Are they taken in Brussels or in Japan?
Dr Jackson: It is a typical Japanese company, so I cannot put my finger exactly where. It would be between me, Brussels and Japan. It sort of happens.

Q170 Chairman: How much does that kind of investment cost? Say for the one that you have got on line last year?
Dr Jackson: Again, it varies considerably. If it is a brand-new model, it can be considerable. We are talking £50–60 million, maybe more—from the manufacturing perspective and parts development. The total investment cost of a car now is enormous. What we try to do, of course, is to limit the amount of investment we have to do, because one of the big costs that impacts on our performance is depreciation. So we do not want to be investing heavily in new equipment if we can modify, amend, and utilise what is there. It is probably part of why we start so soon, because basically that is the time to take cost out of the project. Once you start making it, it is much more difficult; so we put in all the effort now.

Q171 Chairman: I know you are saying that the market is expanding, but are you anxious, when you have a Turkish, perhaps Polish, maybe French, competitor in the field within your own group?
Dr Jackson: No, I am not anxious, because it is the family of Toyota; but I am always aware. We make the Avensis, which is a complex vehicle—a high-value vehicle. It is perhaps beneficial that we can do the added-value stuff. France makes Yaris, which is a much smaller vehicle. Turkey makes Corolla, and so they are a direct competitor to us. They are making the vehicles that are coming into Europe but which also will go *that* way [*indicating*]. Again, it is being close to the market in which they are sold. We are always looking at Turkey, for the Corolla; and we are always looking to Poland for engine manufacturing. It is healthy competition within the family. We are rivals, but we are not going to kill each other—hopefully.

Q172 Chairman: We wanted to get a worldwide perspective from your group as well. Thank you very much. You have been very frank and you have given us a lot of your time. We would appreciate a note on the Emissions Trading Scheme, because it will inform us in our next inquiry.
Dr Jackson: We are happy to do so.

Witnesses: **Mr John Towers,** Chairman and **Mr Peter Beale,** Vice Chairman, Phoenix Venture Holdings, examined.

Q173 Chairman: Thank you very much, Mr Towers and Mr Beale, for coming along today. It does not seem like four years since we first went round the track on this issue, Mr Towers, as far as we are concerned. Perhaps we could start off with your reflections on the period that you have been operating as MG Rover. How have you found the UK as a location for automotive production? Do you think that the positives that you have been able to identify have been sufficiently strong and attractive to guarantee the continued success of automotive production in the UK?

Mr Towers: Yes, for car making the UK is a good place and it is our most important place. We have a heritage, I think, which is quite special in Longbridge—and I guess in the West Midlands as well—in that we have a skills pool and an understanding of car making that has been there for years and years and years. So whilst we would all of us like the Euro to be at 1.20 rather than at 1.50, whilst we would like to think that some of the legislative frameworks that exist here and in Europe and do not elsewhere in the world were different, it is difficult not to speak positively about the UK as a car manufacturing base. The second issue which I think is very important is that the UK is our biggest market and, therefore, we want to be in that market making cars to service that market properly. When you look at the broad range of issues that you think about as a businessman in terms of having a successful business and you reflect on the various items of controversy that we have debated in the industry: skills, for example, is not a direct problem for MG Rover; we can attract, amongst the breadth of activities that we undertake, the right people for the right jobs. I actually do not either have any concern at all about the basic skills issue, when it comes to the previous comments made about graduates, and so on. I think where the skills issue does start to impact most in the UK is as you get further and further down the supply chain and you start to deal with smaller businesses who then, by themselves, are not able to put quite so much resource into their own training of people and their own re-skilling of people. When we took the business over from BMW nearly four years ago our assembly track people were basically skilled in one very confined job; they are now skilled in at least five different activities that they can undertake within the factory. We have done that ourselves; that has not come off the back of any sort of educational process. Many of our suppliers are not able to do that themselves and this is why it is so important that things like the SMT industry forum, which the DTI supports very, very well, in our view, needs to continue; it is why the college, the academy—the things you have been talking about previously (I do not want to go over all of that ground again)—are so, so important. I would say that they are actually more important and more significant for our supplier community than almost anything else. For our supplier community to avoid the issues that they do certainly face and be able to take advantage of the opportunities that could occur through the globalisation of their activities, those skills and those training issues are absolutely fundamental.

Chairman: Thank you.

Q174 Sir Robert Smith: That leads on partly to the question about the supply chain. In your submission you say you are still sourcing 75% of your UK production from UK suppliers, but there is pressure, you say, to go to overseas suppliers. Is training the key thing to reverse that? What can be done to reverse that?

Mr Towers: There are two things that come out of the training, and I am not speaking just about training in terms of fundamental education, I am talking about training in the particular skills associated with being more productive, being more cost-effective and being more quality efficient. That in itself, obviously, helps people compete against some of the very significant price differences that exist between them and, for example, suppliers in the Far East. The other part about the overall business and education of people is that I actually think there is a major set of opportunities. I would reflect on some of the previous evidence that was given, in that in these markets that we are tending to fear as competitive manufacturing bases for ourselves there is, certainly in the short term, a major opportunity of involvement for not just the car makers themselves but, also, the suppliers to the car makers. There is no reason whatsoever why the UK car supply industry cannot be part of that process, but being part of that process does require certain skills to get into it.

Q175 Sir Robert Smith: Are you working with your supply chain to improve their productivity?

Mr Towers: Very much so. I have to say that certainly my personal preference, and I guess our overall preference, is to deal with UK suppliers. However, there has to be a limit that we place upon that preference. One of the things that we do very significantly as part of our global sourcing activities is not to look at global sourcing as an opportunity simply to go there to buy it but to use the global sourcing work to bring information back to our suppliers to try to get them to the point where they can at least be close to a competitive level with some of the people overseas. It would be far better for us to work with them and develop them to the point such that they can compete, or almost compete, with that level of cost than to actually go and buy it there.

Q176 Sir Robert Smith: Finally, in your submission you talk about the Euro and the benefits, possibly, of having a better exchange rate. Do you, at the moment, require your suppliers to invoice you in euros?

Mr Towers: No. The Euro is discussed very popularly as an issue of certainty. One of the biggest things to me is that it should not be the certainty of failure. I would not think that we had certainty in the context of being a member of the Euro if it was 1.50.

Sir Robert Smith: So a sensible exchange rate.

Q177 Judy Mallaber: You heard the exchange earlier with Toyota about the question of EU regulations. Can you tell me what your view is on it? Do you think that the UK is more rigorous in the application of regulations and that it is damaging, or do you take a different view?
Mr Towers: No, I do not take a different view. As an industry we generally feel that we are terribly British in our implementation of regulations. I am sure we do not have a level playing field at all. Could I give you an example which is different from the popular—a little anecdote? I was at an exhibition, as we all are, from time to time, in Europe; our products were on display and there was a delightful German lady looking around our products, she was obviously interested in them and I was in conversation with her and she said how nice they were. It got to the point where I said: "Look, I can organise you a test drive". She said: "There is no point really; I'm German, we have problems with our economy, car manufacturing plays a big part in our economy, I will buy a German car because it is good for our economy." I said: "I cannot argue with that. Funnily enough, we do the same thing in the UK; we like to buy German cars to support the German economy as well." You cannot possibly expect that consumers in your market are going to want to buy British cars. This is not an advert—please—for MG Rover; there are lots of other people making cars in the UK. However, if I say that hell would freeze over before I could sell an MG or a Rover to any French state-run or state-influenced organisation—we know what the Directive is but are we not playing that game ever so correctly?

Q178 Mr Clapham: Mr Towers, could I ask a couple or three questions about production? Could you tell me what the current volume of car production is at Longbridge?
Mr Towers: It is about 150,000.

Q179 Mr Clapham: How does that compare, for example, with when BMW were the owner?
Mr Towers: I think in the last year that BMW owned us we produced about 225,000.

Q180 Mr Clapham: How many people at the present time are employed at Longbridge?
Mr Towers: Directly employed by Rover, we have about 6,250 people.

Q181 Mr Clapham: It is now four years on since you took over. How does that fit with your business plan at the beginning of the venture?
Mr Towers: It is very similar in terms of employment levels. Our original business plan, as we went into the programme—and I think I was widely quoted at the time—talked about a production level of about 200,000 cars. We are at less than that volume right now. One of the reasons for that is that we did find that quite a lot of cars were being sold for significant losses and we immediately took them out of our production processes and, also, our business plan. If you are leading to the point which I think you are leading to, which is when do we start making money properly, then it is around about 180,000 where we break even. So we have some way to go to get to that point, but, nevertheless, we can see ourselves getting there in our current plan.

Q182 Mr Clapham: You say that your current plan indicates you will get there but can you make a prediction as to when?
Mr Towers: I think this year is going to be as difficult as any. I think next year is the point where we would expect to get there.

Q183 Mr Evans: You halved your losses last year and you have just given an indication as to how you have managed that.
Mr Towers: I am sorry, last—?

Q184 Mr Evans: Last year, was it not a £95 million loss?
Mr Towers: Our loss position, basically, went from the £800 million loss under BMW, and then we halved that—we went to about £378 million. We then halved it again in 2002—and they were our last audited accounts—and we came out of that with £95 million. Last year has not been published yet and I cannot give a figure until it is audited but it will be, again, a significant improvement on the £95 million.

Q185 Mr Evans: Excellent. So apart from taking out the loss-making cars that you have identified, what do you put it down to?
Mr Towers: Massive cost-cutting for one thing. Our costs have reduced out of all proportion to the volume changes over those almost four years.

Q186 Mr Evans: Are you able to indicate what sort of costs you have been able to save?
Mr Towers: Again, falling back on a comment that was made earlier, if I could reply to you in writing on that, to give you what is fairly commercially confidential detail, that would be good.
Mr Evans: Okay. Thank you very much.

Q187 Richard Burden: You are involved in a number of joint ventures abroad, from India, Poland, possibly, and have plans in Italy. What do you think the benefits to the company are from those ventures?
Mr Towers: Very significant. Again, to try to add to the debate rather than to repeat things said earlier, one of the most important reasons why we are currently putting a lot of work and effort into China, similarly with Poland and with other areas, is that it would be virtually impossible to do business and sell cars in those territories unless you were involved in the manufacture of them—not necessarily by completely owning the factories there but certainly by having a partnership or a joint venture in manufacturing activity. It is not just a question of wandering around the world looking for cheap sources of supply of cars—quite the reverse. Any cars that are produced in China and, also, arguably, in Poland are going to be mopped up in those territories, not in European territories, over the next

few years. After five or six years I think China could be an entirely different matter, certainly over the next few years, but the fact of the matter remains that if you are going to stand any chance at all of selling cars in those markets you have to be part of the manufacturing process there.

Q188 Richard Burden: In the Far East how do you see your involvement with China developing? Is there any link between that and discussions going on in Malaysia, for instance?
Mr Towers: There has been commentary recently that we seem to be operating on a number of different fronts; they are not actually different fronts, they are quite complementary fronts. Again, I do not want to go into the commercially confidential aspects of what we are discussing, but the biggest, by far, is the possibilities that are available to us in China. The Chinese market is expanding at a massive rate; you have seen the GDP figures—compound 9% growth and looking as though they are going to become the second-biggest car producer in the world in a few years' time—so it cannot be ignored. That is where we are putting the maximum amount of our effort and energy; not (contrary to many rumours) in order to displace production at Longbridge but, in fact, to assist Longbridge in the short term. Why? As soon as you move towards a position of producing your cars in that territory you do not start off with a clean sheet of paper and buy everything there; you have to buy considerable amounts of supplies, of components, of local factory activities in the originating plant. That is a fact of life and that will be of considerable benefit to Longbridge in the short and medium term.

Q189 Richard Burden: Would that logic apply to Poland as well?
Mr Towers: Yes. Again, if I can be, I suppose, slightly colourful, I am puzzled by the fact that the trade unions are telling us today that we absolutely must not stop producing Rover 75s in Longbridge. I am puzzled because we do not want to stop producing Rover 75s in Longbridge either. Given that the Poland process has been going on as long as it has, it puzzles me that people should misinterpret things in that way. It has always been clear that if we set up something at the Daewoo factory in Poland it would be to the benefit of Longbridge, and that continues to be the case.

Q190 Richard Burden: I think the concern, probably, arises around the fact that what is being discussed is Rover 75. If you were producing cars in China for the Far Eastern market, that would be one thing, but I think people would say "Actually, producing Rover 75s in Poland—is it really going to be the case that if you have the same model effectively being produced for the East European market you will also want to continue with production in the UK as well?" This is the danger. If the cost-base is lower there then production will actually shift from Longbridge over to Poland.
Mr Towers: I do not see the difference. First of all, Rover 75 is an attractive proposition in a JV sense. It has been labelled by many people as the best front-wheel drive car in the world, so it is a part of our asset that is quite important in the context of drawing these things to a conclusion. Yes, Rover 75 produced in China, consumed in China and, maybe, part of the Chinese market. There is a huge market within Eastern Europe where we are not represented and where the Rover 75 is an attractive car but where, arguably, by the time we get it there from Longbridge it is probably not price competitive. So it makes great sense to produce that car in Poland if we can get a cost-effective manufacturing base to do it.

Q191 Richard Burden: So it is transportation costs that would—
Mr Towers: No, it is not just transportation, it is the fundamental costs. We are talking about something like 30% of the cost base to produce the car in Poland. Why should that mean that we would not want to continue to produce cars in the UK?

Q192 Richard Burden: You do not think it would be cheaper to import back into the UK?
Mr Towers: I think it would be cheaper, but I am not sure it would be a wise business decision to do that.

Q193 Richard Burden: In terms of capacity at Longbridge—again, looking at where production may go—Rover 75 is produced there already. One of my colleagues will be coming on to talk in a while about projected new models and so on. Would there be a possibility that those new models, if produced, could be produced on an existing line, or would it mean opening up a new line? If it is the former, which model would go to make room for it?
Mr Towers: Again, similar to the evidence that you have heard before, as far as we can we try to make the existing facilities suitable for the new models.

Q194 Richard Burden: So there would be the capacity at Longbridge to open up a new line to produce a new model without displacing—
Mr Towers: Without throwing everything away. Absolutely. There is huge capacity at Longbridge. I was interested in the earlier capacity debate because, arguably, you could say that Longbridge could produce 350,000 cars a year—which it has done, and it has done more than that. The thing that is most important is how is the business geared, what is the break-even point and, therefore, what is the profitability point in having a thriving business? I guess, if you totalled all of the UK capacity together, you would actually come to about 2.6, 2.7 million cars, which is more than we actually consume in the UK. The important thing is how are the businesses geared. I thought the Toyota explanation was very good. Where is their profit point, where is their break-even point and what are they actually planning to produce?

Q195 Richard Burden: As well as that capacity, in terms of physical capacity at Longbridge, there is a scenario that would suggest that if a new model came on the tracks the 75 would move off to go to Poland. That would be completely wrong?
Mr Towers: Every single process that we are engaged in would be to the benefit of Longbridge not to the detriment of Longbridge; every single discussion that we are having, every single JV outline that we are looking at, right from the early days of our JV discussions, every single one has been premised around being to the benefit of Longbridge.

Q196 Richard Burden: So 75 production stays at Longbridge?
Mr Towers: Yes.

Q197 Chairman: You have been in business now for just over three years.
Mr Towers: Nearly four years.

Q198 Chairman: How many JVs have you entered into?
Mr Towers: I think the one that we started first—and I think this reflects the length of time it actually takes to get a JV to a conclusion—was the one with Tata. In fact, that is a very interesting example of the Longbridge benefits that I was talking about earlier. There is a car that is not produced at Longbridge, it is produced in India but it is marketed through our UK marketing organisation. It is a car that was not previously here and it has actually created jobs within MG Rover, not because of manufacturing issues per se but because of the input we have had with Tata and also because of the distribution arrangements when it comes to the UK.

Q199 Chairman: One JV with Tata. How many manufacturing jobs are we talking about out of the 6,250?
Mr Towers: Absolutely not many. I am simply making the point that because you enter into arrangements with people on a JV basis does not necessarily mean it is going to be to the detriment of the people back at home.

Q200 Chairman: What I am trying to get at is it might not be to the detriment of them but it does not seem to be greatly to their advantage, given that the cash flow that is coming in will not be going to the plant but will be going elsewhere. I am just not quite clear. The JVs that you are envisaging in Poland and China are concerning a vehicle which is, what, three years into its life now?
Mr Towers: Yes.

Q201 Chairman: So it is almost facing a midlife crisis, shall we say, in terms of its longevity. How does that fit in with new models coming in? You are extending the production of a previous vehicle abroad, but it is not—although it may contribute to cash flow—the kind of joint venture, as I understand it, which spreads research and development and planning and marketing costs across several markets simultaneously, is it?
Mr Towers: Maybe I can speak to that issue of R&D and new products. You may recall when we bought Longbridge from BMW we had three cars: we had the MGF, the Rover 25 and the Rover 45. The first thing we did was to bring the Rover 25 out of BMW and out of Cowley, and we introduced the estate version of that. We then did the MGZR, ZS, ZT; we replaced the TF; we introduced the SV models and we introduced the X Power ZT 260 and further models. We now have 11, and at the Geneva show we showed the new 75 (the 04 model 75) and we also unveiled the V8. During the rest of this year we have two new models coming along, which we have not announced yet but they will be here this year.

Q202 Chairman: Based on the 75?
Mr Towers: Based upon certain aspects of engineering that we have, yes. That factory now has 11 cars when it had three. So we have not been idle on the engineering front during the time that we have owned the business. In looking at the future, and our future investment plans, then of course we would like to partner with someone to get into the new markets, to get into the economies of scale that you would all recognise we would be irresponsible not to do.

Q203 Chairman: However, in the intervening period your output has fallen from 225,000 to 150,000 and you are still 30,000 short of the figure of 180,000 that you would identify as the sort of break-even point?
Mr Towers: Yes. Another way of putting it is that in the intervening period we have improved the losses by £700 million.

Q204 Linda Perham: You mentioned two new models possibly coming out. How difficult is it for a firm of your size to finance new models?
Mr Towers: We do work differently from the typical industry players; there is no question of that. You hear a lot spoken about the cost of a car's development—typically, billion-pound type sums are put forward. We certainly do not spend that much.

Q205 Linda Perham: What is the time frame if you are thinking of introducing new models?
Mr Towers: A typical new model takes three years. If you distinguish between, first of all, facelifts and then significant engineering programmes and then completely new platforms, platforms last for about seven or eight years and you do significant work on them in between times. We have a new platform that is scheduled to be in production towards the end of next year. The rest of the work that we have carried out has been significant engineering work on existing platforms.

Q206 Mr Hoyle: You mentioned new platforms. Which model is that aimed at? Small, medium or large?

Mr Towers: Medium.

Q207 Mr Hoyle: So it is about the 45?
Mr Towers: Forty-five and a bit bigger.

Q208 Mr Hoyle: Forty-five plus a bit. Obviously that is a new development and that will go down at the Longbridge site?
Mr Towers: Yes.

Q209 Mr Hoyle: I want to take you back to your earlier comment, because you said that when you took over the company you had only a couple of models going down.
Mr Towers: Three.

Q210 Mr Hoyle: In fairness, the new Mini was meant to go down and it was in exchange for the 75, so I think you really would have had four, whichever way it had gone. I was pleased you did the move quite easily to Cowley and back between yourselves and BMW. The 75 has been the backbone; you have extended it, you have put an extended model in there as well, the slightly stretched limo of the 75, but what is the life expectancy? As the Chairman pointed out, we are just over four years into the lifespan of the 75. Okay, you can move it out to Poland, and that is what Vauxhall have done with their aging models. Do you see the 75 as being moved on and that there will be a replacement for Longbridge of the 75 in the process time?
Mr Towers: First of all, the 75 is an extremely modern—

Q211 Mr Hoyle: It is an exceptional car. So long may we have them.
Mr Towers: Thank you. A very modern car and an extremely contemporary platform. Frankly, the 75 is the least of our concerns at the moment, in terms of new platform engineering development. It would not be correct to link our conversations about Poland or elsewhere with the possibility of the 75 platform requiring replacement. Not at all; it does not require replacement, it is an excellent car.

Q212 Mr Hoyle: Absolutely, and that is why it is the only car you have got to negotiate with, whether it is in China or whether it is in Poland. Of course, the MG is a very good model but it is not a value model that you can hawk round the world, whereas with the 75, in fairness, if I am right, you can negotiate quite well into China, because it is modern, it is a good platform, it is a robust car and it is a quality car—all the things you have said. Presumably, Poland will also give that advantage because is it not a new factory, the Daewoo factory, in Poland?
Mr Towers: It is very modern.

Q213 Mr Hoyle: Absolutely, and one that has never been used, so they will want to bring it into production. I think the temptation—and this is the worry that has been touched on earlier—is that if you start producing in those two countries, really, what stops you bringing that back into the UK if they turn out to be very good ventures?
Mr Towers: The MG, ZS and the Rover 45 platform is a double wishbone, front suspension, with some of the most modern engineering in that platform that you could ever wish to find in any car today. There is nothing—absolutely nothing—wrong with that platform in a contemporary context. The fact that a car called Rover 45 has been around for a long time does not mean that massive, massive things have been done to that platform. I wish we would all get it out of our heads that we are dealing with something that is not particularly attractive, because that is not the case. The fact that the motorsport version of that car is one of the most competitive products on the racetrack actually tells you how good that platform is. So that is the platform point. The second question which you raise is "What stops you, once those manufacturing bases are established in China or Poland or whatever, bringing them back to the UK?" Nothing stops us, except the fact that I am telling you that Longbridge is going to make those cars.

Q214 Mr Hoyle: That is fine. I hate to just pursue it—
Mr Towers: Which, by the way, I am able to tell you because I do not have to ring Tokyo to find out whether that is the case.

Q215 Mr Hoyle: That is brilliant. I once dealt with McDonalds in a very similar way in Chorley. They opened a new store and they said "Don't worry, we won't close the McDonalds on the other side of the town because we believe we have got the advantage of operating on both sides and we are going to take full advantage." Guess what? We have only got one McDonalds and it is the new one that we are left with.
Mr Towers: Because McDonalds had to ring Tokyo, did they not?

Q216 Mr Hoyle: No, they did not, unfortunately, because it is a franchise and they operated both. So just to say to you that I think the point is you have tried to reassure us today, we are going to accept your commitment, it is actually an investment for the Eastern Bloc and it certainly is not one to export back to the UK. We can take that as a guaranteed assurance?
Mr Towers: Yes.

Q217 Judy Mallaber: Can I follow on from that? We have just been in Malaysia and it would be interesting to know how the letter of intent with Proton ties into the things we have been discussing, because I do not think we learnt very much when we were there.
Mr Towers: I heard that you had difficulty meeting with Proton. I cannot understand why that would be the case. Kevin Howell, our Chief Executive, would have very much liked to be here today; we were trying as late as last week to reorganise things in order for him to be here. He is actually in Malaysia right now, as we speak—hopefully he has finished the discussions he was having this morning on that very subject. The discussions are progressing quite

well. The one thing I do not ever do, under any of these conversations with JVs, is to create a greater expectation of timeliness than would be the case; they do take a long time and you do have to put a lot of effort into these processes and they do take a long time to consummate. Yes, those discussions are going well and we look forward to some significant benefit for ourselves and Longbridge out of the process.

Q218 Judy Mallaber: What sort of benefits would come to Longbridge out of it?
Mr Towers: The business development activities for a combined arrangement between Proton and MG Rover would involve two possible platforms, both of which we would be involved in and both of which would involve us in major economies of scale and for which both plants would be engaged.

Q219 Judy Mallaber: So you are talking about production at both ends?
Mr Towers: Yes.

Q220 Judy Mallaber: Not just using your opportunities for them to assemble.
Mr Towers: No.

Q221 Sir Robert Smith: Answering Mr Hoyle you were expressing a frustration that platforms should not be seen to be out of date so quickly, and they are perfectly good products. Is not the reality of the way the market has been developed, and in which your competitors, at least, operate and the customer, that the expectation is that you have to have a new platform and new models turning over very quickly nowadays to satisfy the sales of new cars?
Mr Towers: Very much so. The activities that you will see from us this year will reflect that. We do new things to our cars every year, every two years, every three years, but that does not mean a new platform each time, and that is the distinction.

Q222 Chairman: We have seen various reports about the restructuring of PVH. I wonder if you could, maybe, talk us through what has happened there?
Mr Beale: Perhaps I could pick up on that? When we took over the Rover Group it was one large organisation. I do not think anybody was very sure whether Landrover was making money or losing money; whether the Rover Group was losing this much money or that much money or how much Powertrain was making. So we followed a perfectly normal—almost textbook—way of running a group of companies; it makes sure there is complete management focus on each of those elements and that no group directors can actually hide. It creates a huge amount of transparency in the individual operations of those companies. So we have separated out our manufacturing, our parts operation, our Powertrain operation and quite a few other group companies as well. It has paid huge dividends for us. It does not necessarily make any of those companies more viable by splitting out the companies but it does allow us total scrutiny of those businesses and how they are doing. It also helps us gain third party business in some cases, and Powertrain is a very good example of this if we are selling engines to some of our competitors, because they are more happy dealing with a Powertrain company than a MG Rover-branded company. I guess, if you wanted a little micro-example of why this works so well, I would take—which is a very small business on the general scale of things—Studley Castle. When we took over, that was a vaguely interesting overhead of the business; it was a slightly luxurious overhead, a place where, generally, in-house conference facilities were used. We have now separated that out, taken it away as being a distraction from the MG Rover Group Board; it has now got its own board of directors there and it is now a profitable business. Under 10% of its business is in-house business, the other 90% is to third-party sales, it makes a contribution and it makes a profit for the benefit of the rest of the Group. So it is actually turning an overhead into a profit, and that is what we have done with each of these businesses and focused on, perhaps, the harsh reality of life, that MG Rover is a significantly loss-making company but some of the other parts of the business make a significant profit.

Q223 Chairman: How does this splitting up of the business and the re-orientation of some of the revenue streams facilitate increased investment in Longbridge?
Mr Beale: I suppose there is a confusion here about the reporting requirements of a group of companies and where the actual cash flows to and from. Basically, the way our cash flows is that our cash comes out of our private company and ends up in the manufacturing company, which does indeed support not only the losses but the on-going product development.

Q224 Sir Robert Smith: Just following that up, I was recently in India on a visit by Lib Dem Friends of India, paid for by the Indian Government, and we did meet Tata and saw their enthusiasm for the deal they have done, from their side, and they were particularly impressed with your dealer network. You mentioned earlier how Longbridge benefits from that deal, but if the companies are all separated is it not the dealer and distribution side that benefits?
Mr Towers: Let me give you a very graphic example. We said right from the outset that we could not—given our more limited resources—and would not, be investing in our own small car. We felt that was simply not a responsible business position to take at that time, and for the medium term. Equally, we know that for a retail organisation a full range of cars is a major benefit, but it is not just a benefit for the dealers themselves; the more footfall we can get into our retailers to see not just, perhaps, the small car that they are interested in but to see the range of cars the better it is for our overall organisation and the more likely it is that people will appreciate the MG Rover range—more than they do today. We are not a business that has the resources to spend billions on advertising; we are not on the television

every second of the day, so getting the footfall through our dealers with another sector product can only be of help to the Longbridge business.

Sir Robert Smith: Thank you very much.

Q225 Richard Burden: Pursuing the kind of line of questioning that Martin asked a little earlier on, the allegation, put bluntly, has been that far from splitting up the businesses helping and channelling cash into the car business it has been draining money away from that. There has been speculation about that in the press. Could you explain why that is not the case? For example, perhaps you could explain the structure of the company and, in particular, how the financial flows do work?

Mr Beale: I suppose I could answer that very, very simply, if you want to look at it purely from an accounting point of view. Where is the cash in our balance sheet at the end of the year? For anybody who wants to look at our statutory accounts, the cash is in MG Rover. The cash from the well-publicised sale of the land, which was the sale of land from our property company, was actually paid into the MG Rover Group bank account and is there at the year-end. There are allegations, yes, but there is no evidence to support any of those allegations. It is just total nonsense.

Mr Towers: It is quite the opposite. Let me give you a very, very real perspective on this. Wind the clock back four years and look at the company structure as it was with BMW—which seems to be the type of single structure that people would like us to return to. As an outsider from that business you would not know what at all was going on; nobody outside that business was able to pick up a set of accounts and understand what was going in the business. Today anybody can do that; anyone can pick up a set of accounts and understand everything that is going on in each of the individual segments of the business. To some extent, the fact that we have all of this information flowing around the press about us is a clear indication of transparency. Are people seriously suggesting that we should go back—and these are the suggestions that we are getting—to that single, homogenous structure that was completely impenetrable and completely opaque? I shall not mention the name but I read one newspaper which was continuing to identify our structure as extremely complex over and over and over again—issues of its complexity—and then found in the actual article a very simple diagram simply identifying the structure of our company. I think this is just completely silly.

Q226 Mr Djanogly: It is not the complexity of the company structure, it is the way that following the restructuring, assets—which of course are more than just cash and include land—have been ring-fenced in companies that would effectively mean that if the motor manufacturing components of the group went, the rest of the assets would be ringfenced and therefore questions have been asked as to the motives behind the restructuring, in my view quite validly although there may have been good reasons why you wanted to organise things in that way. The question that arises is whether the restructuring of PVH with car production isolated from the profitable elements in any way hindered the introduction of the new models, for instance.

Mr Towers: No.

Mr Beale: No, and in answering your question about the way ringfencing would work, if we were trying to ringfence assets your property example is a very good one, one would have left the cash in the property company, one would not have taken the cash and put it back into the company, so it is very difficult to tackle this problem when if we had left the business as it was it would have carried on losing £700 million a year and we would not be here to have these interesting conversations about what we have done with our assets. Like you, I can understand why people may suggest that, but there is certainly no evidence to support it and I think our actions show completely the opposite effect.

Q227 Mr Djanogly: For instance, there have been a lot of articles written about your company in the last few weeks.

Mr Beale: I have read some of them.

Q228 Mr Djanogly: *Guardian,* 2 March: "Questions are now being asked about how PVH has chosen to distribute the BMW dowry"—that is the £1.1 billion that you received.

Mr Beale: I do not recall ever receiving £1.1 billion.

Q229 Mr Djanogly: Okay, why, because some of it is in land and so forth?

Mr Beale: Because we received £427 million.

Q230 Mr Djanogly: Plus land and companies given in shareholdings and so forth. It says some industry analysts are concerned that cash is being conserved to prop up day-to-day operations rather than invested in the development of the new medium-sized models regarded as essential to MG Rover's long-term survival.

Mr Beale: Yes, we have used the cash to help our losses. If we had not done we would be able to introduce new models. I do not quite understand the question.

Q231 Mr Djanogly: When you were responding to Mr Hoyle's earlier question about the proposed middle-range new vehicle, is that production yet funded?

Mr Beale: We have spent just under £460 million on engineering since May 2000. Approximately £100 million of that is on the new medium car which is substantially complete from a platform and engineering point of view. There is still the ability to do more work on it to effect the styling which we hope we will do in co-operation with a joint venture partner.

Q232 Mr Djanogly: Do you still have to raise significant amounts of money to put that car into production?

Mr Beale: We had a fairly healthy cash position at the end of last year. I think if you look back on our accounts we have had substantial cash balances at the end of each year. We have managed our business very carefully from a cash point of view, we have sweated our assets at every opportunity. It is something we are getting very skilled at. Will we have sufficient assets and cashflow to complete the medium car by ourselves? If we have to, that is what we will do but that is not our preferred route. Our preferred route would be to share those costs with a joint venture partner.

Q233 Mr Djanogly: You will see where I am coming from. If you did not have the cash to do that then would the assets around the group be up for developing the new car?
Mr Beale: Again we have shown already that if we do need to raise additional cash we have the ability to do it. We have assets such as the land we raised some money on at the end of the year. It is not our preferred route; we prefer not to sell off assets to complete the new medium car. We do need a new medium car though, that is absolutely essential, so we will have one. Our preferred route now is to get one of the many joint venture companies we are talking to on board, allow them to share in that platform, which means sharing in the cost as well as the revenues from it, and complete it in that way.

Q234 Richard Burden: In the non-MG Rover subsidiaries within PVH, for instance the property company and Sudeley Castle and so on, what kind of proportion of the profits made by the profit-making subsidiaries have actually gone to supporting the development of new models or otherwise supporting the car business and what proportion would go towards covering head office costs?
Mr Beale: Obviously there are head office costs but apart from those head office costs, 99% of the cash we generate from those group companies goes back in. We tend to keep a small amount of cash in each subsidiary to meet its day-to-day requirements and so on but if you were to ask me what the total amount of cash is today in all our companies outside MG Rover, bearing in mind we are talking about hundreds of millions in MG Rover at any point in time, it would be under £10 million in all those other companies including PVH.

Q235 Richard Burden: And how much would have been distributed in dividends to individuals?
Mr Beale: None. We have never paid a dividend from a holding company to any shareholder. There was some confusion in the press, and I might be predicting where your question is coming from, because a dividend was paid from Techtronic to a holding company in December 2000 but that was a strange accounting quirk because we could not prepare accounts for the holding company to 31 December 2000 because it had only been in existence for six weeks but all dividends that have been paid in our company have gone up to the top holding company and not one penny of dividend has gone out to any shareholder.

Q236 Mr Clapham: Could I ask you a couple of questions on the shares because it is important. Your employees, for example, receive shares in the company although they do not have voting rights and they are based on the profitability of MG Rover rather than on the profitability of PVH overall. I heard what you said about the dividends, that you do not pay a dividend but could you say whether there is some trading done amongst employees and is it possible to say what the value of the shares is?
Mr Beale: No, it is not possible to say what the value of the shares is. Our company can be valued in many different ways so, no, I would not like to express an opinion on the value of it. Just to be clear, though, when we set up the share scheme we were very careful to word the share scheme knowing that we were going to enter into this restructuring process so what we gave the employees a share in—and I think they understand this, perhaps the outside world does not understand it so well—was the businesses we took over from BMW so it is a very broadly written trust document. If we take something like Xpart out of MG Rover they still own a share of both companies. It was done in such a way that it did not restrict our ability to move assets in companies across the group.

Q237 Richard Burden: Given that there was terrific support in the community for your taking over of the company and an engagement there by the workforce, is there not a feeling amongst the workforce that they should be able to put some valuation on the shares that they have?
Mr Beale: I suppose I would probably like to know how much my shares are worth, and I think that is a very valid point, but the shares are only worth what somebody would be paying for them. I am sure you could get many accountants to do an evaluation of our balance sheet, look at our assets, certainly look at our intangible assets, like our brand name and IPR, and come up with a fairly high valuation. On the other hand, somebody else could look at it and see some of the problems we have talked about here today, about it is still loss-making and it is going to be difficult moving forward and put a very low figure on it. I certainly would not like to be the accountant who was asked to express a valuation but I can understand that people sat there with a share certificate would very much like to understand what that share is worth. I am not sure that is how the majority of the workforce would look at it. I think what they are most interested in is are they going to be carrying on in employment, are they still going to be working at Longbridge, and are we going to be carrying on putting investment back in Longbridge. I think that share certificate is some evidence that they are a stakeholder and partner in this business.

Q238 Chairman: Can you tell us a wee bit about MGR Capital. How does it relate to PVH?
Mr Beale: MGR Capital was quite an interesting exercise. It is mistaken for being the finance company of MG Rover, which it is not. Any commission on all cars that have been sold since we took over the company are shared between the bank

putting up the finance and the dealers. We do not take a share of that at the moment although it is one of the strategic objectives to do so in the future as our financial abilities improve.

Q239 Chairman: You say we do not; does that mean that you as the rest of the group or you as the gang of four?

Mr Beale: Nobody does, MG Rover, the gang of four, nobody. I will come on to explain what MGR Capital is because I think that will answer your confusion. What MGR Capital is is the business that BMW had written when they were selling Rover Cars under their ownership. It was a static book debt of some £327 million that was owed to BMW Financial Services by various customers that had bought cars. That was not for sale because BMW did not want to sell it but it was fundamentally important that MG Rover actually acquired that book debt for two very good reasons. Firstly, it is a huge database of people who have bought Rover products so it enabled us to market those customers as their financial agreements came to an end as opposed to BMW being able to market them and try to convince them to buy a new Mini or a 3-Series. Secondly, BMW had entered into an inter-group contract that basically said if any of those vehicles when they came up at the end of their financial lives lost money compared to the expected value then Rover Group had to pay BMW Financial Services for it. Those losses in the first 12 months were running into many thousands of pounds per vehicle. BMW had no need or desire to sell our cars in the second-hand market in an efficient manner because we were underwriting it, so it is absolutely crucial for MG Rover Group to either get control of that book of debt by themselves or have somebody who would favour MG Rover owning it. Unfortunately our financial advisers could not find a way of MG Rover or PVH buying that book of debt because of the impact on our balance sheet showing that huge liability so the only option that was left to us was for us to enter into the arrangement personally which involved us putting up a fairly serious personal stake in conjunction with a major bank to get control of that book of debt. So we did take some personal risk. We hope we will one day get some personal reward out of that but the benefit to MG Rover was £20 million/£30 million/£40 million saving in residual value losses plus the ability to market those customers so it was absolutely crucial that we did that for the company.

Q240 Mr Hoyle: It is interesting we are on about the share certificates. Your critics are very critical of the company, and we have talked about the press and without doubt they have certainly gone to town at times, I think you would agree with that. Do you think it is fair when your critics call the share certificates "junk bonds" because there is no real value and nobody really knows the outcome?

Mr Beale: I think that would be very unfair on our workforce. I think they take some pride in those share certificates.

Q241 Mr Hoyle: Even if they do not know the value?

Mr Beale: Yes.

Q242 Mr Hoyle: That is interesting.

Mr Beale: I think they are evidence of being a stakeholder in the business. If you speak to any of my workforce they are very, very passionate and very, very committed to the company. The turnover in our staff is very low.

Q243 Mr Hoyle: They are tied in as well. I understand that.

Mr Beale: A lot of them are very proud of those share certificates.

Q244 Mr Hoyle: That is great. To take that on, of course the company came along and stepped in and I believe the decision was right. There were two choices and the Phoenix coming out of the ashes was wonderful news. Obviously the press then went on to say there is money being taken out of the business and that was part of the headline you touched on before, that they do not understand how you financed the business and how you moved money around. What is the commitment of the directors? What personal guarantees have they got in it and what do they stand to lose if it did go wrong?

Mr Towers: Could I just mention one part of this. You said there were two possible outcomes. There were only two possible outcomes, and that was closure—

Q245 Mr Hoyle: It depends how you look at it because we could rewrite history.

Mr Towers: The point about this is on 9 May 2000 when we arrived at Longbridge having signed the deal with BMW there was no alternative. The liquidation team had actually landed at Birmingham Airport. Alchemy had pulled out three weeks earlier. There is a lot of conversation going on about the Alchemy alternative. There was no Alchemy alternative. Alchemy had been advised that the business deal that they were facing was too high a risk, as had we. There was only one alternative to closure. The liquidation team had arrived. When we got to Longbridge they were very happy to get back on the plane and go back to Munich but they had arrived and that was that day that they were going to set the liquidation process into place. Again, I do not want this to sound as though it is appealing for anything, it is simply putting the facts to right. We had huge emotional support from all over the place, not from everywhere but from all over the place and we were very grateful for that. We were particularly grateful for people who again in an emotional sense placed themselves a little bit on the line in support of this but at the end of it all there were only four individuals—not four individual businesses and not four individual millionaires—just four individuals who were prepared to put their hands in their pockets to actually save that business, not the banks, not the government, not the financial institutions, no-one else, and without that happening the business would not be here. 6,500 people directly and another 25,000 people indirectly would have lost their jobs. Four years later it is quite easy to forget that. Four years later, after six months of being told we were not going to be in business for nine months and then another 12 months of being told we were not going to be in business for two years, to be sitting here today and still hearing those same sort of comments is really quite startling—and I am not saying from you, I am saying from the outside world—but most importantly completely forgets that initial situation that all of those people faced. Sorry, I just wanted to make the point.

Q246 Mr Hoyle: I will come back to that in a minute. Do you want to answer the question?
Mr Beale: Sorry?

Q247 Mr Hoyle: The guarantees?
Mr Beale: What have we actually put into business?

Q248 Mr Hoyle: No, no, if the company were to go what is your commitment in personal guarantees?
Mr Beale: That was what I was going to say. I was going to go through the history of it. We certainly had personal liabilities in excess of £1 million on day one. We put £240,000 of our own money into the company which we would lose. We had to put up £500,000 cash each for MGR Capital and put quite a lot of personal assets at stake for that business which for me personally would have been personal devastation if anything had gone wrong over the last two years since we did that deal, so a lot.

Q249 Mr Hoyle: Are they still there at this stage?
Mr Beale: Yes.

Q250 Mr Hoyle: What I am trying to get to is you have put a lot into keeping this business going and you still stand to lose if this business were to go wrong so you have got an added interest committed to this business to keep it going long term. That is what I am trying to get at.
Mr Beale: Absolutely. Just to be totally fair, I would say that our personal guarantees and so on in MGR Capital get less as time goes on because as the book debt goes down the possibilities of losses are much lower today than they were 12 months ago when it was very scary levels. Yes, absolutely, and it is not just our financial commitment, it is our reputational commitment. People like John Towers and Nick Stephenson and our other business partners have a reputational risk in taking on this business. They have had hugely successful careers and so it is not just the financial, it is more important than that, it is the reputational risk that they are running in keeping this company going and improving it as time goes on.

Q251 Chairman: If things are so good why are they so bad? "Phoenix feathered its nest with Rover's prize assets", "MG Rover drives into storm over rewards". This is not the *Socialist Worker* or the *Morning Star*. We are talking about the *Daily Telegraph* and the *Daily Mail*. How have they got it so wrong?
Mr Beale: I have to answer to my wife every evening when I go home because she keeps reading in the paper that I am a billionaire.

Q252 Chairman: £31 million between four of you is a good start. That is the figure that is quoted.
Mr Beale: If you put it in the context of our workforce we are very well paid, we have good salaries, we have well-reported loan notes, we have a good pension scheme, so yes, we feel we have been fairly treated out of this deal.

Q253 Chairman: Who treats you by the way? There are only four directors, are there not, so there is no salary committed.
Mr Beale: Fairly treated by events compared to, say, the company running out of cash or running out of business after 12 or 18 months. We could have been treated very differently by events.

Q254 Chairman: But you have treated yourself rather well, have you not, in the sense that there are four of you and you are able to decide how much you get in your pay, there is nobody else on the board. It is not very good corporate governance, is it?
Mr Beale: It is probably the same corporate governance that applies to every private company in this country.

Q255 Chairman: But it is a private company that was dependent at its foundation on the goodwill of an awful lot of public individuals, a lot of people, your workforce included, and they are now excluded from this process of being involved. You say it is more transparent but, as my colleague said, the transparency seems to be a rather effective conduit to looking after yourselves.
Mr Beale: I do not quite understand the transparency issue because I think—

Q256 Chairman: You say that you are splitting it into different bits.
Mr Beale: But our salaries and pensions schemes seem to be in every newspaper in the country. I think we are the least transparent private company—the most transparent private company in the country.

Q257 Chairman: The most transparent, yes! I take your point but the point I am trying to get at is that you are rewarding yourselves, that you are the judge and jury on your own success or failure, and there are a lot of people out there who have got valueless (because nobody is able to put a value on them) share certificates.
Mr Towers: A huge amount—

Q258 Chairman: The scale of your industrial achievement is being undermined by what appears to be financial sleight-of-hand, not necessarily anything illegal but just the manipulating of book-keeping practices in such a way you are doing rather well and everybody else is just muddling along.
Mr Towers: Could I make a few points. First of all, we truly valued the emotional support, there is no question about that, on the other hand, I repeat

myself, we were the only people who put our hands into our pockets, so that is one issue. Secondly, the question of moving things around, the process is entirely transparent, if it were not transparent then there would not be reporting of such issues. Has the reporting been correct? No, absolutely not. Let me speak freely about my own salary. My salary is £36,000 from MG Rover as a director of MG Rover and £246,000 from Phoenix Venture Holdings from the other businesses we are involved in. That is my salary. I do not think that is the impression that people get. I am not going to talk about anyone else's salary, that is mine. Is it transparent? Yes, it is. Has it been correctly reported? No, it has not.

Q259 Chairman: Has it been wrongly reported in the sense that it is not true?
Mr Towers: Yes.

Q260 Chairman: But you have not sought legal redress?
Mr Towers: Yes.

Q261 Chairman: You are in the process of doing so?
Mr Towers: Yes.

Q262 Chairman: With any prospect of success?
Mr Towers: I am a car maker, I am afraid, not a lawyer.
Chairman: Okay. Richard?

Q263 Richard Burden: Could I just take you back to the financial flows inside the group of companies. Again one of the allegations has been around interest payments, that the loan from BMW was an interest-free loan in respect of what at the time was called Rover. Within the group though interest is charged from the parent company down to MG Rover. As I understand it, you have said that is normal accounting so that the car company knows the cost of the capital it is using, but where does interest go when it is charged?
Mr Beale: The interest goes from MG Rover to Techtronic. You say that the loan was to the car company. The loan was never to the car company BMW always made it clear that they would only deal with Techtronic alone.

Q264 Richard Burden: It is to Rover.
Mr Beale: It was to Techtronic. This was the legal agreement that was drawn up that BMW would enter into a loan with Techtronic, it would not enter into a loan to MG Rover. MG Rover simply lends that money to Techtronic. It is not just that money, other money gets lent and the money returned, it is a moveable feast. Yes, Techtronic charges MG Rover interest on that. If you asked any colleagues from the other car companies do they charge interest on inter-group debt they would probably also say that is the case.
Mr Towers: As did BMW.
Mr Beale: BMW charged interest to Rover Group, substantially more than Techtronic is charging MG Rover Group. For all the companies in a group—and this is exactly the same with other groups—interest and dividends flow up to the holding company. The holding company has certain costs. That cash is then made available to the rest of the group. In our case it simply lends back down to MG Rover as and when it is required which is why I say at any point in time we do not finish up with huge sums of money in PVH, we actually finish up with just a few million pounds in PVH, the rest of it is lent back to MG Rover to help sustain their losses and new product development. I do not understand any comments, and I rather take issue with any allegations of financial sleight-of-hand. It is standard textbook ways that groups of companies are run. I think if you ask the same questions of any private company of our size or certainly of any of our competitors sat here today their companies will be run in exactly the same way. It is the right way to run a company and we are very proud of it. I cannot quite understand the words accusations and allegations of financial sleight-of-hand. I am very, very proud of what we have achieved in this company and the way it is structured.

Q265 Richard Burden: I am just trying to clarify because the allegation that has been in the press is that interest charged within the group—
Mr Beale: How can that be an allegation? It is like saying you get interest on your deposit account.

Q266 Richard Burden: The allegation is that interest charged within the group from the parent company to MG Rover generates interest that does not get recirculated back into the car business. Now what you are saying is that that interest does recirculate back into the car business.
Mr Beale: I would also take issue with whether it would be an allegation if it did not. I do not quite understand why it would be an allegation in the first part. As it happens we need to put it back into MG Rover to fund projects but it certainly would not be an allegation if we left it there because that is how a lot of companies would run their business. BMW for example every night put all the cash of all their subsidiaries into their parent company overnight to get good returns on the money market. Is that financial sleight-of-hand? Should that not be an allegation? It is almost impossible to defend against something which is not an allegation in the first place.
Mr Towers: Unlike any private company I have ever known, not only have we clarified these issues as they have come along but we have also invited qualified people in—I am not just talking about lay people—we have had accountants from our trade unions in and we have invited them to go all of the way through our books. Yes, we are concerned and as you can see from time to time we are really quite irritated that this nonsense is flying around in the way that it is to the extent that we have invited qualified people in, opened the books and let them go through everything. They have gone away, as a lot of people know (it is not that widely reported but a lot of people know) entirely happy with what they have seen.

Q267 Chairman: As I understand it, in part at least, the money that you were given from BMW and the money came from the proceeds of the sales of cars and what have you, was to meet obligations that might arise or liabilities that might have come about had the company had to stop trading. Is that correct?
Mr Beale: There were no conditions on what the money could be used for, whether to settle liabilities or not. We put a simple business case to BMW. There were lots of interested consortia going around putting various propositions. Our proposition to BMW was simple: "We think we can make this business work." It was terribly important that BMW believed that. There was a huge danger that they would give us the well-reported dowry and then if we failed they would then be attacked by the liquidator to put back in the money they had taken from before, so we had to put up a very robust business plan. The reason we were successful was partly because of what we at the time were using was 100 years' experience in the motor trade—John Towers, Nick Stephenson, John Edwards and myself. So we did put a very good business case to BMW. They had an expectation on the one hand if they did close the business as they were intending that they would have huge liabilities because BMW do tend to be very fair and proper towards their workforce and dealers. They had a view that this was quite a high number. We suggested a much lower number and we eventually settled after much negotiation (this money was not just given to us) on a figure of £427 million in cash.

Q268 Chairman: As I understand it, the fairness of BMW as an employer was such that they wished to ensure that redundancy payments would be rather more than just the state minimum and that at least part of that money—
Mr Beale: I know one thing they were intending to be fair on was their dealers. I am not quite sure what the redundancy attitude would be. You may well be right.

Q269 Chairman: Put it this way: had Longbridge closed and they had been the employer, the workforce would have walked out with more than state benefit. It is not unreasonable to imagine that within the £427 million there would have been an element which would have taken account of that?
Mr Beale: I see where you are going; it is simply not the case. BMW had worked out what they thought the liabilities of closing the plant would be, which would be many—there would be the redundancies, there would be the dealer liabilities when they shut down the dealers, et cetera, et cetera, et cetera—and they came up with a very large figure. We never discussed how they built up that figure. All we did was offer them a different solution and that solution was for a certain cash sum, which we settled on £427 million, we would go down this route. So, no, the £427 million had no logic in that regard whatsoever.

Q270 Chairman: Would you say then that in the unfortunate tragic event of you having to lay people off in sizeable numbers you would have the resources to be able to offer them more than the state minimum?
Mr Beale: I think probably if you followed your logic through you would have suggested of that £427 million we did not invest it all in new models and losses but we put some of it aside to plan for failure. That is simply not how we run our business.

Q271 Chairman: The thing is you are no longer required to do that even if you wanted to and you have just indicated that you do not want to. The point I am trying to get at is was the money made available (and you and I can agree to disagree perhaps) as is my understanding, this so-called dowry, not just for the distributors but that there was a sense of responsibility towards the workforce as well?
Mr Beale: I am sure that is right. We are arguing about different things, I think.

Q272 Chairman: We can lay that to one side, I think. Really what I was concerned about was in the event of there being difficulties for you, am I right in thinking that you would be in a position to treat your workers in a way that is more generous than the basic state payments?
Mr Beale: Who knows what? I cannot envisage what that failure would look like. Certainly there would be a lot of assets within the group and if we did happen to have an accident and run out of cash one day in many years' time there would be assets within that group. Certainly any assets in the group would be at the disposal of the administrator or liquidator to settle as he saw fit. It is certainly not something we are planning to do.

Q273 Chairman: I hope you do not, with respect, and I do not mean that in a nasty way. One last point, there is a great anxiety at the moment across British industry, across working people about the question of pension entitlement. Can you give any indication of the health of the pension fund at the present moment?
Mr Towers: Many British plcs I think would give their right arm to have the employees' pension fund that we have. We have a pension fund that is £160 million ahead of the minimum funding arrangement. All these funding calculations are falling into disrepute and there is a new system coming up, but against the minimum funding level we are £160 million ahead, against the RS17 level we are something like £76 million behind. You can take your own different views of those two numbers but perhaps the most significant thing about our pension scheme is this: that we have something like 5,840 current in-work members and something like 142 retirees, and of course the company loan has paid £50 million into that pension fund since we started,

so we have a fund where significant funds are flowing in and where there are actually very few people who are drawing benefits from the fund. There is a big membership profile totalling 6,000 but very few people who are drawing funds out of the group. As we all know, one of the reasons why many funds are getting into difficulty is because they have it the other way round. They have a huge number of people who have retired who are drawing funds and a lesser number of people who are paying into the scheme and this is why companies are finding it an awesome task to keep the schemes going. As a matter of information, when these discussions were going on with BMW and we were getting all the sound, sage financial advice we were told that we ought to abandon the final salary pension scheme and move to a money purchase scheme, which was an increasing trend. We do not want to do that. We think we should be continuing to maintain the same level of potential benefits that we always have done for our employees.

Q274 Richard Burden: The trade unions have been critical about some decisions that have been made by the company, in particular the trust fund and the loan note, but they have nevertheless been fairly defensive of the company against some of the allegations that have appeared in the press. They have made a suggestion that in order to dispel those allegations, however unjustified the allegations may be and to answer the "what if" scenario of the kind that has just been talked about, the company could usefully look at an independent director on the board. Others are suggested things like a covenanting arrangement to answer the "what if" questions. Has the board considered it?
Mr Towers: I think the company should do that. Equally, another audience of people say, "Look, you are a private company and private companies do not have these things, why do you?" Okay, we are a private company but sometimes we are regarded as a mixture between a private company and a piece of national heritage or something, so you cannot dig your heels in and say, "We do not have to do that, we are a private company." By the end of this year we shall have done something of that nature. It would be a sad thing if we have to do something which is pretty useless and not contributing to our process, and so hopefully it will be useful and it will contribute to our process as well rather than just being a message, but I think we should do that.

Q275 Chairman: We are taking evidence from a number of car companies, some of them far bigger than you, some of them more profitable than you, some of them employing far more people than you, but the fact is that, as you say, you were borne on a wave of public goodwill which has become somewhat frayed at the edges. There may be other institutions that come to mind of a similar character but I will not go down the road of my own personal grief in that sense. The point I am getting at is there is a sense in which you have maybe created a stick to break your own backs by laying out the re-organised structure of the companies and then by laying yourself open to the kind of scrutiny that you have had and that perhaps some gestures to try and restore the goodwill and the trust that was endowed in you nearly four years ago might not be a bad thing. I say that I hope not in a pious-sounding way but there is a sense in which you as the last major British car manufacturer have a certain place here and there is a great dependence on it. In some respects we take the view that you have a critical place in the economy of the West Midlands and the car industry and the supply chain, a supply chain which a lot of other companies would have great difficulty surviving if your business was not there to keep them going. I think the length of time we have spent and the degree that we have gone on is evidence of our concerns. It is not necessarily evidence of hostility but it is, I think, an opportunity to air a number of these issues. We are very grateful to you for the answers you have given. We may want to come back to you and see if we can get some other points in writing. If you are agreeable to do that we would be happy.
Mr Towers: Sure. In the context of goodwill by all means visit our company and talk to our employees and you will see what continued goodwill really means.

Q276 Chairman: The only problem is they are not the only people who have to buy cars so we will leave it on that note.
Mr Towers: I simply offer that as an observation.
Chairman: Thank you for your evidence.

Witnesses: **Mr Roger Putnam,** Chairman, Ford of Britain, and **Mr Joe Greenwell,** Chairman and CEO, Jaguar and Land Rover, Ford Motor Company, examined.

Q277 Chairman: Good afternoon, gentlemen. The last session went on a wee bit longer for reasons I am sure you understand. We are almost in the position—and it is something I would never say about any of your models—where we have got "boring" old Ford now, not in any kind of nasty sense, as a two-car Ford family, but anyway, there is a marked lack of notoriety surrounding you at the present moment. Can I just welcome you here and perhaps, Mr Putnam, you would like to introduce yourself and Mr Greenwell.
Mr Putnam: Chairman, I chair Ford Motor Company Ford of Britain which we will call Blue Oval for the purpose of this afternoon, that is the corporate badge of Ford, looking after the 465,000 vehicles that we distribute here in the UK every year, or we did last year. Joe Greenwell on my left here looks after the luxury UK brands, Jaguar and Land Rover.
Mr Greenwell: I am Chairman and Chief Executive of Jaguar Land Rover, which is part of the Premier Automotive Group which also includes Aston

Martin and Volvo.

Q278 Chairman: It seems strange, we do not really think of Ford as a foreign company in some respects, you have been here for such a long time. In either capacity, as Brits or as employees of a foreign car company, what do you see as the strengths of the vehicles here, that is almost one in five of every vehicle sold in Britain. Although we do not manufacture passenger cars as Blue Oval, we still have enormous investments here, in fact in the existing plants we invested something close to £2 billion in the last four or five years so we see Britain as an absolutely vital part of Ford's global business.

Q280 Mr Djanogly: It has generally been acknowledged that there is over-capacity in car production on a global basis. Despite this, UK manufacturers are increasing output. Do you see any kind of crunch arising here?

Mr Putnam: Perhaps I can speak for Ford. Obviously the over-capacity has had to be dealt with, unlike some of our colleagues who are late arrivals in comparison to 101 years of involvement. Our structures obviously owe a lot to history and that is not just true here in Britain but also across the rest of Europe and so we instigated a European turnaround strategy three years ago which was focused on several major projects. One was to try and rationalise our European capacity, which resulted in one of our car plants, Halewood, becoming a Jaguar plant, and shortly a PAG plant. Dagenham ceased car production but of course is now a major diesel engine manufacturing plant which exports a huge percentage of its volume and is looking to increase that volume. We have had to look not just at Britain but across Europe. We have closed plants in Poland, we have closed plants in Portugal, we have taken 5,000 people out of our Belgian operation and 2,000 people out of our German operation so this is not just a UK issue, it is a means by which we ensure as best we can in a volatile and extremely competitive business our survival over the long term. As I say, you do not take a £2 billion investment lightly if you are planning to make further changes in your business.

Mr Greenwell: Capacity is an issue unquestionably and capacity utilisation is an issue for Jaguar Land Rover as it faces its challenges. There have been dramatic changes since we met before in terms of the volume profile of Jaguar and Land Rover. When I joined Jaguar in 1982 there was a global sale of 20,000 units. As a result of consistent investment from our parent, Ford Motor Company, with new product-led introductions, that volume grew to around 50,000 in the late 1990s and now stands at around 120,000–130,000 units. As Roger said, the adoption of the Halewood Plant, which has demonstrated a fantastic turn around to produce our new X-Type premium saloon. Land Rover was acquired round about the time that you were last meeting in June 2000. That company underwent a trebling of volume between 1992 and 2000 towards its current level of 165,000–175,000 units. The challenge facing us is that we have continued to invest substantially, as you will be aware from our submission, in both Jaguar and Land Rover in new product development, in facilities, £1 billion in the four plants and two engineering centres represented by Jaguar Land Rover, over a period of about five years. We faced a prospect of new product-led growth in Land Rover. The company is poised and Jaguar is consolidating its four model lines. The driver for that growth was going from a two-model line-up to a four-model line-up. I will not take you through the detail but this year we are adding to every one of those model ranges to grow our business. The challenge is essentially exchange rates. It is all very well to grow geographically as we have done but our ultimate task is to achieve a satisfactory return on our investment, the parent company's investment, which of course was part of the original acquisition objectives of both Jaguar and Land Rover, so we face challenging times although in sales volume terms we have some very encouraging progress and expect that to continue during the course of this year with some major product launches from both brands.

Q281 Mr Djanogly: Just to follow up on that, the exchange rate problem is what, selling British cars into the US?

Mr Greenwell: Principally.

Q282 Mr Djanogly: So the problem would be there if we had the Euro?

Mr Greenwell: Yes, depending on what value the Euro is at it can exacerbate or mitigate the impact of an adverse dollar–pound exchange rate. This is not something that is new to us. Jaguar, if Roger and I go back, have always been either in a good position or a less encouraging position on the dollar–pound exchange rate. At the moment, as I have said, while we have new product-fuelled growth the impact on margins is significant. When you export, as we do, 75% of our product at Jaguar and 70% at Land Rover, we are a global player and we are used to applying the appropriate measures in terms of hedging contracts to mitigate. To pick up on some of the testimony that I heard earlier on this afternoon, our drive and our focus on costs is more rigorous than ever because we have to regard that as a business as usual process rather than some occasional mitigating effort to reduce the impacts of exchange on our bottom line.

Q283 Sir Robert Smith: Can I explore that a bit further because in paragraph 56 of your memorandum you say you support early entry at a competitive exchange rate to the Euro and then you go on to say "or at a rate that does not position the British economy at a long-term disadvantage". So is your desire for stability so great, even if it is not fully competitive, that you prefer to fix the rate?

Mr Putnam: I think stability is all. I echo colleagues from Toyota, when you have got the volatility we have seen generally, one hopes that one is a little bit luckier in that you do not get major changes in both dollar and Euro at the same time. This last one has been pretty difficult for anybody exporting from

Britain because when the Euro was strong the dollar was down and vice versa. Frankly, if we could nail one of those to do a five-year business plan against that volatility it would be an advantage. Manufacturing margins in all manufacturing business are pretty slim and if you are making between three and 5% you are doing quite well. When you can get a 15 to 18% movement, as we have seen, in 50% of your revenue, it makes five-year business planning a hopeless dream.

Q284 Sir Robert Smith: How much have you tried to pass the currency risk down the supply chain in terms of requiring invoicing in euros?
Mr Putnam: We have long-term partnerships with our supply base and that would not be feasible. We would not go very far if our supply base were in severe financial constraints.
Mr Greenwell: 50% of our supply base at Jaguar Land Rover is to UK-based companies, about 35% in euros, but to low-cost sources, which you referred to earlier, it is about 15%. So I think two things. Firstly, you can understand why we and some of the other people who have given testimony today work genuinely very hard and with great rigour with our UK supply base through the SMMT Industry Forum and in partnership with government to try and introduce world-class standards. That said, however good our strategic platform is (down hopefully against a stable exchange platform base) you have to look around. You have to look at the ultimate long-term context and I think our investments, our history and the data you have in front of you demonstrate that our parent company, Jaguar Land Rover, have demonstrated a long-term commitment to the industry in this country.
Mr Putnam: I think also, perhaps uniquely, Ford has a portfolio of brands including Volvo as a more recent acquisition as well as Land Rover four years ago, and for those world-class suppliers here in Britain there are synergies we can bring to invisible parts like door-lock mechanisms for example where the customer really is buying a car with a burst-proof lock regardless of how it looks or whatever, and those capable world-class suppliers here in Britain could find themselves manufacturing huge quantities of individual items which would not just go into vehicles made here but vehicles made on a global basis.

Q285 Mr Evans: Do you understand the fear that some people have that with these ten countries coming into the European Union that a number of manufacturing firms here might want to up sticks and move there where there is a lower cost base?
Mr Putnam: You mean vehicle manufacturers?

Q286 Mr Evans: Generally and I think the fear is therefore that you being a manufacturer would be included amongst them.
Mr Putnam: I would hope that for a variety of reasons, and I would like to say with great foresight but I dare not say that totally, we restructured our business much earlier than the current environment would have demanded and therefore we took our decision to put our UK manufacturing base into a different place to where it had been for decades which is very much in the high quality, high premium business, be it diesel engines or luxury vehicles. I think because of the commitments we have made—again I go back to the £2 billion that has been invested in the last four years—any move to a cheaper cost base would be to provide additional volume to those markets.

Q287 Mr Evans: You have quite rightly said that you have invested considerable sums of money in the United Kingdom and that that investment will continue. I am just thinking that as far as future investment plans are concerned you think that Britain can hold its own against the attractions that the other ten countries would bring forward?
Mr Putnam: I am afraid that we do always have to do a sanity check or a benchmark check when we make investments and the RSA position here in Britain is certainly nowhere near as favourable as we have seen elsewhere. That is always going to be a consideration. Having said that, we are looking very seriously at some increased capacity in Britain and I will try to ensure with my colleagues in Ford of Britain that it goes into Britain

Mr Evans: I declare my interest as a Jaguar owner. Unlike the Deputy Prime Minister, sadly, I only have one.
Chairman: That is why you are not the Deputy Prime Minister!

Q288 Mr Evans: That and other reasons why. I am sure that he does your brand a great deal of good! I am just wondering with the new market that is there, these 75 million-plus people, do you see that as an opportunity for the prestige end of the market as well? You only produce Jaguar in Britain; is that right?
Mr Greenwell: Jaguar and Land Rover built-up units. We are a prestige car company. We are making 120,000–130,000 units a year for Jaguar. We hope to get a record this year. We make 170,000 Land Rovers. As I said, that has emerged after a period of growth of both brands. So we are talking 300,000 units. We are facing German competition. Frankly, they make three times that number of units so we are dealing in the premier end of the market, which of course is what the overall strategy is to be incremental in terms of Ford's base products globally. I come back in terms of our commitment to the fact that they are solid British brands, they have a recent track record of intensive investment in order to lead this new product-led growth, and investment too in working with suppliers and working with young people in terms of training in base skills and process. It is further evidence of a commitment to the industry in this country. As Roger rightly says, I do not think you are going to get an unqualified assurance regarding the placement of investments over a 30 or 40-year timespan. The track record of Ford Motor Company is to think long term on investments. We are not going to chase exchange rates in terms of the siting of plants and facilities.

You are talking hundreds of millions of pounds here. If there is major evidence of structural change such that we do not think that it is a reasonable prospect to achieve our ultimate financial objectives, then we need to look at that with some care, but I have described (as Roger has) the kind of strategic context we are working in here. It is that of a company that is strongly committed to Britain but wanting to work very, very hard on cost within the infrastructure and, frankly, use its size and overseas low-cost sources of supply to its advantage as appropriate.

Q289 Mr Evans: Do you see those ten countries as a potential market for your premium cars? You say that you compete against the Germans and they are producing Mercedes almost everywhere.
Mr Greenwell: They are a million plus. We do find ourselves facing principally BMW and Mercedes and Lexus from Japan—we are never going to be a substantial volume player in some of these markets. Take Jaguar, for example, it is 50% in the USA. It has been higher going back when Roger and I worked there first time round but 25%, our second biggest market, is the UK and next up is the Eurozone. On a base of 120,000 units the volumes are relatively modest.

Q290 Mr Clapham: I hear what you say about the European market but the real growing market is going to be Asia, is it not? For example, we visited the ASEAN countries and it is good to see, Mr Greenwell, that the small Jaguar is very prominent in Singapore. I saw quite a number.
Mr Greenwell: It has got a very good distributor there.

Q291 Mr Clapham: But we have got the Chinese market coming on there. Do you see this as being a likely attraction for companies to refocus? Is Ford UK, for example, likely to be considering refocusing nearer to the larger market?
Mr Greenwell: In terms of volume and the way we would manage our strategy in that market it is probably best if I let Roger start, I think.
Mr Putnam: Going back to what we in Blue Oval produce in Britain; we produce Transits and about 54% of them are exported all over the world because it is a light and medium commercial vehicle and has an appeal in every market where people need to move goods around. We also produce diesel engines. The Dagenham engine plant is a brand new ultra high-tech diesel engine plant and in the next three years one in four Ford engines that go into every Ford car worldwide will be produced here in Britain, either at Bridgend or at Dagenham. That is the extent to which we will be exporting Britain to markets in the Far East. I think developing markets like China need roads before they need luxury cars to a certain extent. They are very well furnished in places like Shanghai, which is where you get taken, but when you get a bit further out it gets a bit closer to oxen than to luxury cars.

Q292 Mr Clapham: But you see that opportunity for expansion with regard to the diesel engine units?
Mr Putnam: Absolutely. We have cutting-edge technology. We have a joint venture with PSA, which in fact is the engine that Dagenham produces, which is a joint venture engine, a six-cylinder V6 2.7 litre, which is about to go into its first application in Jaguar.
Mr Greenwell: It is extremely important to us. In China when I say modest volumes I think last year we sold 150 Jaguars and 700 Land Rovers. That is expected to grow significantly but these are built-up units that we are importing for sale. Longer term if one looks at the growth in the industry in China, which I think is the point you are making, certainly one would hope over time a premium segment would develop within which we could compete. I do not think—and I may be wrong—it would be sufficient to justify a local manufacturing source for Jaguar although Land Rover has some potential. As part of our strategic review in Asia we look routinely at prospects in that area but as part of the Ford motor car enterprise approach to China because it makes much more business sense for us to do it.

Q293 Linda Perham: Just staying on the Dagenham engine plant for a moment because it employs a lot of people in my area of London, we visited there four years ago when we did the previous inquiry. What changes have there been in the workforce, numbers or different skilled people, because of its change to being the engine plant?
Mr Putnam: From the original car plant?

Q294 Linda Perham: Yes.
Mr Putnam: I do not have that data because it predates my time at Ford but I will certainly be happy to let you have it.

Q295 Linda Perham: Thank you. You did just mention joint ventures as well. We have heard of car companies increasingly becoming involved in joint ventures. What do you see as the benefits of those sort of arrangements?
Mr Putnam: If I can perhaps take the lead on this. Let us take the example of low-carbon engines, low-carbon fuels, alternative fuels. I notice that my colleague from Toyota mentioned the Low-Carbon Vehicle Partnership. I actually sit on that board so I have a pretty close interest in how that develops. There are many routes in which we could move forward. I guess the general popular view amongst the industry and governments in Europe is that hydrogen-based fuel cells will be the ultimate goal, but there is no infrastructure, there is no sustainable way of making hydrogen at the moment so that is a long-term holy grail, if you like, and many manufacturers follow different paths depending on their own economy or their own environment. Without a doubt diesel engines are the main low CO_2 producing form of propulsion in Europe at this moment in time, hence our investment in Dagenham and our intention to use that engine plant as a global supply route. Mazda, one of our companies, is pursuing hydrogen. Volvo is looking very closely at

Compressed National Gas because it is a sustainable product from biomass. I am told because of the huge forests in Sweden this is a good thing but I understand a lot of it is imported from potatoes grown in Poland, but that is another issue. I do not think all of us can pursue all these routes at the same time. The cost in a very competitive industry is huge. Joint ventures enable us to share technology, to enjoy technology transfer, to get cutting edge. Ford itself has a joint venture with Toyota on hybrid technology for example. We in turn are likely to supply them with diesel engines because in Japan it is a low-cost petrol market and diesel engines are unheard of, rather like the USA, so all these areas take the maximum benefit from, if you like, the environment the home manufacturer finds himself in. We are totally different in structure to the Japanese market so we can co-operate and not replicate or duplicate some of the running costs that we have to go through to meet the Kyoto standards.

Q296 Linda Perham: Are there any countries where you could not operate unless you were in a joint venture?
Mr Putnam: In terms of sales companies and manufacturing, yes, there are many, China being one where you cannot operate without a joint venture agreement with a Chinese partner in manufacturing. We have been to Malaysia. We cannot operate there without a Bumiputra partner and that is true in Indonesia too. I suspect that arrangement will stay, so in many cases you have no option and this is a way of protecting, I guess, the local companies and ensuring that the local expertise is maintained.

Q297 Mr Clapham: Just turning to components, Mr Putnam, the UK has got an extremely large components sector but yet we see that the amount of UK components being used in British-produced cars is falling off. Have you got any particular explanation for that? Could you say for example, what proportion of UK-produced components Ford uses in the cars that are manufactured here?
Mr Putnam: We only manufacture Transits here so I guess Joe is probably better versed because he sells 300,000 vehicles across Jaguar and Land Rover.
Mr Greenwell: Ultimately for a premium brand company it is about quality and technology and performance. If we could go to a UK supplier and get a transmissional steering ramp to match the one we can get from a European source in terms of performance and technical capability, which fits the drivability in the case of Jaguar for example, then that will be relevant to us. The fact is, however, that if you are working on a premium brand and your customers have expectations in terms of the vehicle—its feature level, its equipment level, its dynamic performance, its behaviour—commensurate with the price he is paying, you have to make sure you have the very, very best of product quality and technology content, and I do not mean to suggest that is simply not available but in some major components you would want it is necessary for you to go elsewhere. That said, it is precisely that kind of technical capability that we are trying to encourage with the rump of suppliers who of course represent the bulk of our purchasing base. We want to encourage world-class standards of process, R&D expenditure and technical competency and that is an industry-wide responsibility. At the end of the day an American customer or a German customer when he is evaluating a product in a ride and drive situation versus a BMW, a Mercedes or a Lexus or any number of other competitors, we have to be the best. In the XJ and Range Rover we happen to think we have two of the world's finest products. We think we have got an effective balance in terms of the UK supply base trying to encourage institutionally the UK supply base but also picking the best components if we have to go outside. Some of the best components are from within Ford Motor Company because of their investment in research and development and we can work with Ford engineers, for example, on the latest generation technology diesel engines. There is this tremendous unit, as Roger says, that we are about to launch. Where was our best source? It was within our own company.
Mr Putnam: I want to make one point about the fact that we still spend £8 billion in the UK as a buying company which is over one-third of Ford of Europe's entire spend so it is still pretty huge. On top of that we spend between us £1 billion in R&D per year here.

Q298 Mr Clapham: What I was going to ask Mr Greenwell was whether your engineers could be used to encourage some of your suppliers to improve their quality and productivity?
Mr Greenwell: We are doing that all the time. You have heard evidence from a number of people and we would not want to sequester that initiative—it is an industry-wide initiative working with the DTI and the SMMT—but having a UK supply base over 50%, in light of everything you know and have heard over the years, is not a bad effort on the part of our company and reflects continuous dialogue. If anything, we need intensification of that dialogue. Fortunately we have some excellent media devices such as the SMMT Industry Forum and of course the recently announced Automotive Academy. All of those initiatives represent a way to encourage the industry itself to move towards genuinely world-class standards and act in a coherent and joined-up way.

Q299 Sir Robert Smith: You have made some quite interesting suggestions about over-regulation and one of the earlier witnesses talked about each brick at a time is okay but the whole wall coming at once is maybe too much. We wanted to specifically address one of those concerns that you have backed at the SMMT about trying to get implementation in other EU countries the same as here. You put it that way round maybe. Do you have any examples where the UK has been more rigorous in its implementation of EU Directives?

Mr Putnam: I think the most obvious one is something I mentioned earlier which is CO_2. We are the only market in Europe which has legislated its company car tax based on CO_2 output which when the rump of British manufacturing is in the luxury sector does penalise large engine vehicles and, as Joe said earlier, 75% of Jaguars are exported and 70% of Land Rovers are exported. It is very hard to be a strong exporter if your domestic market is under threat on a non-level playing field basis. I am sure that the German government would find it very difficult to penalise their own home industry in a unique way. As much as we are working extremely hard to reduce CO_2 output I think it would take 200 Focuses, today's most popular Ford, to produce the same pollution level as one Anglia of 1967 so that will give you some idea of how things have changed. I think I have got it the right way round!

Chairman: You did not have to have so many Anglias!

Q300 Richard Burden: I hope that was not an announcement of a model launch of a new Anglia! Actually my question follows on the issue of clean technology. You heard what Toyota said earlier on about the way they would like to see things like the Power Shift Programme developing and their comments on the Low-Carbon Vehicle Partnership. What do you think the Government should be doing in terms of promoting cleaner technology, whether it be engines, whether it be fuels, whatever?

Mr Putnam: Again I have to declare an interest being on that board. I think it is an excellent initiative. It has yet to get its teeth into anything substantial but, as Toyota said, we approved at last week's board meeting a centre of excellence for low-carbon fuels development. I think the real push the Government can give is to ensure that we spend an adequate amount of money. At the moment we are not talking a huge amount. If you look at what is being spent in Europe we are probably down below a quarter of what is being invested by some of the other European governments. That is something that I think needs a close eye kept on. Admittedly we are probably going to help a lot of SMEs and smaller companies with technology. Unless there is rigour in the way the thing is structured and run, it will be very hard to attract the big OENs to get involved because of loss of competitive advantage and so on. It needs a little more thinking through and I have certainly made that point in the board.

Q301 Richard Burden: The next thing that links in with trying to promote cutting edge technology here, is Toyota today were fairly much of the view that in relation to motorsport they saw the involvement of the UK in that as principally a marketing tool rather than a driver of technological development. Would you see it that way?

Mr Putnam: You have the advantage of knowing my background. I spent 16 years at Lotus and I ran Jaguar's race programme so I am pretty involved in motorsport. I also sit on the Government's Motor Sports Board. I would have to say that the opportunity for technological transfer as we used to see is less—and of course Jaguar used disc brakes on D-Types back in the 1950s on the sports model cars and that transferred into virtually every road car that you see today. I think the sophistication of Formula 1 and the cost does preclude the same sort of technological transfer you used to see, which is why in the Government's Motor Sport Board we are desperately trying to revive grass-roots racing programmes. Although club racing is thriving very successfully we need to look at things like energy efficient saloon car racing. I sit on a small subgroup to try and encourage diesel engine race cars, again applying low carbon technology to the sport to make it more consumer acceptable. They see it in racing cars and I think that is where we can get technology transfer rather than in hardware as it used to be. You look at the data control unit on a Formula 1 car which is the size of a matchbox and there is little use for that on a car on the road because it costs £85,000. That is where the cutting edge of the sport has gone but I believe there is a lot more that can be done to transfer sentiment perhaps. That is not marketing, that is something quite different, it is getting the consumer to accept some of the things that we have to do to reduce CO_2.

Q302 Richard Burden: What about education and skills?

Mr Putnam: As you know, we have the Motor Sports Academy. I have had them down at our own public-private partnership site at Dagenham to give them a taste of how they could structure. John Grant who is leading it is making good progress. Again I think this is absolutely fundamental to everything we do in the industry now, be it motorsport or getting people into the industry and the engineering and manufacturing side, and to perhaps answer your question before you ask it I think the Government could help not just the automotive sector but manufacturing industry in general by providing us with some overall guidance to make industry much more attractive to kids at school. We do a lot of work with school children, Jaguar too with their Formula 1 in Schools, which is something I think is vital. We have to find the little gems in our business that are attractive and push them out into the community at the lowest age where it is seen as something attractive.

Mr Greenwell: I would endorse that. I think the Formula 1 in Schools initiative is an excellent carrier for the industry and the leading edge aspect of it. I agree with Roger, the promotional value of involvement in Formula 1 globally, if you added up what you have to spend in terms of fixed marketing or advertising, remains a very efficient carrier of a brand. I think for an engineering-based company—and essentially Jaguar and Land Rover are engineering companies—there is something to be said too to be able to take advantage of what is a kind of fast-moving laboratory in terms of the electronics, materials, leading edge technology but also leading edge process management. Having access to that kind of expertise, that kind of fine leading edge advanced technology is appropriate for Ford Motor Company but it is appropriate for a premium maker in particular. In terms of involvement with schools and young people it is an incredible motivator to stimulate interest in our business in manufacturing and in engineering in some exciting aspects of the job.

Q303 Linda Perham: What is your view about the effect of the changes in the block exemption rules?
Mr Putnam: How effective have they been or?

Q304 Linda Perham: Well, the changes in terms of how they have affected servicing arrangements with dealerships?
Mr Putnam: Not to any great extent. We at Ford have found it quite difficult to attract authorised repairers into our processes and systems. I think the mind-set among the independents is quite different from the regulated mind-set that we have to impose. I think at the end of the day we live in a world which has now got endless benchmarking companies measuring our success or otherwise in delivering customer satisfaction. That drives process and that drives costs. Getting authorised repairers to invest in those processes is quite difficult so we have not seen any great measure of an increase in authorised repairers any more than Toyota have. I think it is very early days. I do worry about the way in which there seems to be a consolidation of dealer businesses and the possibility—and I have no data or proof of this—that smaller dealers or rural dealers are selling up and moving away, which cannot be to the benefit of the consumer.

Q305 Linda Perham: Your evidence says that that is the case. Have you got any evidence to back that up for smaller dealers?
Mr Putnam: I can only talk about our own network and that is true. We are finding it increasingly difficult to find new investors in rural areas and I worry that the whole basis of the level one market concept here in Britain could be undermined by the fact that we are not going to see the multi-brand effect that perhaps we hoped but it is very early days. In my mind the jury is out until we have seen a lot more changes. The large dealer groups are very profitable at the moment, which cannot be said for some of the smaller dealers. If that balance is redressed then we may see a different picture emerging.

Q306 Linda Perham: You impose conditions obviously for approving servicing of your vehicles. Do you think in your case or other manufacturers they are overly stringent?
Mr Putnam: Compared to Jaguar they are very, very lax because the requirements of a luxury car owner are quite different to a volume car owner. As I said, we cannot escape the fact we are under the microscope by a whole range of outside measurers/benchmarkers who measure our customer satisfaction, which has a major impact on how the public see us. We do not impose processes or costs on our dealers that are not totally in line with the levels of service work and excellence and expertise that we believe are demanded by the customer.

Q307 Chairman: Thank you, gentlemen. I think we have covered all of the areas we wanted to. You tend to find as the day goes on our questions become rather shorter and the fact that we have not taken quite as long as we did with your predecessors is no disrespect to your organisation or to the rigour of your responses. Thank you very much. If there is anything else we need to get in touch with you about we will.
Mr Putnam: I will certainly follow up on the Dagenham numbers of employees.
Chairman: Thank you.

Witness: **Mr Brian Spratt,** Chief Executive, Automotive Distributive Federation, examined.

Chairman: Good afternoon, Mr Spratt, it is getting near the end of what has been a rather long day for us but we will, I am sure, pay attention and sit up straight, as my wife, an old school teacher, would put it. We have had a number of references to your body, the Academy, over the last wee while and I think my colleague Robert Smith would like to start.

Q308 Sir Robert Smith: Before I start I know much of your submission has been looking at the after market but with the other witnesses we have been pursuing the supply chain in the manufacturing side and the drift away from UK suppliers and we are just wondering from your perspective whether vehicle manufacturers are doing enough to try and work with their supply chain to improve productivity?
Mr Spratt: I look at this as an onlooker to that part of the industry because the after market is our area of expertise. We do see efforts through things like the Industry Forum and other initiatives for the vehicle assemblers to encourage tier one, tier two and tier three suppliers to improve their expertise and their cost bases and everything else to make sure they stay in the supply chain. My perspective is slightly different because I tend to talk about the units fitted on vehicles when they are being serviced when they are on the road, and it is that drop in component supply from the UK base which really formed the focus of my submission.

Q309 Mr Clapham: Mr Spratt, the evidence that we have had suggests there is a significant consolidation underway in the components industry. Do you see this as helping competitiveness or are you still a little pessimistic, as was expressed in your submission?
Mr Spratt: I am not normally a pessimist but, no, we do see areas where for competitive reasons companies try to ensure their survival by making sure they consolidate their efforts as they can, whether that is by consolidating here in the UK or whether it is by moving things into other countries. I think it would be fair to say that the majority of

replacement unit suppliers into the after market are subsidiaries in some way of overseas companies. Those companies tend to take their decisions in slightly different ways to perhaps a UK-based company.

Q310 Mr Clapham: What we have heard from the evidence given by the motor manufacturers is that they see themselves as being a stimulus, should we say, to greater productivity amongst their suppliers, not only that but helping to improve the quality of some of the components. Do you find that they do work in that way?

Mr Spratt: I think that is undoubtedly true, particularly if you are threatening to take a contract away that is likely to act as a stimulant, so that is right but hopefully it is not just a stick, there are also some carrots along the way. Generally speaking the SMMT's Industry Forum works quite well in terms of providing expertise and encouragement for those companies to improve their performance in all areas.

Q311 Richard Burden: Another thing the SMMT have said is that the increases in production in the former Eastern European countries and in Asia obviously present some challenges to the component industries but quite a lot of opportunities as well. How well placed do you think the components sector is to take advantage of those opportunities?

Mr Spratt: To use those areas as centres of supply? I think that is happening already. The industries that are being established in those areas are new industries in the main so they hold the advantage of new machinery often at a lower cost base. You mention Asia. Turkey in particular is a major provider of car parts not just for OE parts on the line but it is also providing parts for the after market. Last week was the commercial vehicle show at the National Exhibition Centre and I had three Turkish companies come to me and ask if they could join my organisation.

Q312 Richard Burden: Are there opportunities that you think could be exploited in terms of those markets as opposed to those being bases for production to exploit our markets?

Mr Spratt: My view is that it is more difficult to see it from that angle. When I look at the UK component supply industry, these tier one to three companies, they tend to be not the units that I normally deal with on a day-to-day basis. They tend to be the integral part of a body for instance that you would not normally see as a part you could sell somewhere other than to the original vehicle assembler. So the idea of actually exporting some of those parts to other parts of the world is not on because those vehicles are not produced there or they are but not the normal replacement parts.

Q313 Linda Perham: You claim that the changes to the block exemption rules are being undermined by the vehicle manufacturers. Is there anything that could be done about that?

Mr Spratt: We are just discussing that with some people who have complained to us. I should explain a few weeks ago I acted on behalf of one of my member companies in speaking to a large number of his garage customers and I invited them to bring to us any instances of warranted refusals through the independent garage servicing or any other restrictive practices, and just this week we have actually had some information fed to us but we have not had time to investigate it fully unfortunately. If we think that the problems that these people have reported to us are in some way infringing the block exemption regulations then we will be speaking to the Office of Fair Trading.

Q314 Linda Perham: Have you had any information that this is a problem in other EU countries?

Mr Spratt: Certainly there have been infringements. In Germany Mercedes were required to drop one of their marketing ploys which showed if you took a servicing agreement with Mercedes the garage that did the servicing would only use Mercedes parts. That is against the block exemption regulations and Mercedes have had to remove that part of that service agreement rule.

Q315 Linda Perham: And I do not know if you were in when we were talking to Ford but I was asking about the impact on smaller independent dealers. I think you have identified that as well. Is there a real danger that a lot of them are going to go out of business?

Mr Spratt: I have not examined dealers very closely. Independent garages, some of whom wish to become authorised repairers, are finding that the hurdles they have to leap to become authorised repairers are rather high. It is a question of judgment as to whether it is artificially high or not. Is it there to keep them out and keep the dealer family happy or is it an actual justifiable cost based on some technical requirement for their businesses? 30,000, which is a figure I used in my submission, is a figure that was quoted by Citroen and they have subsequently found that only a small percentage of the people who applied have followed up the original enquiry and tried to become authorised repairers. I do not know how Citroen arrived at that figure but I know that in certain cases part of the stipulation is for specific sorts of carpet tiles in the reception area and things like that, so they hardly seem to impinge on the quality of the repair that the motorist is receiving from the garage or the dealer.

Q316 Mr Evans: Are you suffering or any of your members suffering from a skills shortage? Have they complained to you about that?

Mr Spratt: Yes they are. It always surprises me when I look at all sectors of the motoring industry that we seem to have a rather bad image as far as newcomers to the industry are concerned at whatever level they come in at, whether it is school-leavers or further through the educational system. It is an industry that deals with a highly technological product but we still have the "greasy hands" syndrome. We do note that the type of people that we get offered to us, generally speaking, particularly at the school-leaver level are not really useable without an awful lot of work from ourselves. They are not being presented to us in the way we feel they should be. I am sure that has occurred in other industries as well. I am very pleased to see some of our members' efforts in conjunction with local technical colleges in actually producing courses which address those basic skills shortages and also introduce people to the world of work properly and the world of the automotive after market.

Q317 Mr Evans: Did you say the technical colleges are doing this now or should be doing this?
Mr Spratt: Some colleges are doing it and some of them are doing it in co-operation with some of our member companies, which is very worthwhile.

Q318 Mr Evans: You think there should be a lot more of this to ensure that we do not have a skills shortage?
Mr Spratt: I think so. The partnership between these colleges and potential employers, whether in my industry or not, is very, very important. It is very easy for educational establishments to carry on their work in a vacuum without realising what is required by the eventual employer of that particular person.

Q319 Mr Evans: Will the Automotive Academy address the component parts as well?
Mr Spratt: I am not intimately involved with the Automotive Academy. I have seen some aspects of its work. It seems to concentrate mainly on the vehicle assembler and then the dealer network. I am sure there are areas where some of our needs and our efforts are mirrored by theirs but they do seem to be focused on their end of the industry rather than my independent after market sales.

Q320 Mr Evans: That might be a shortcoming then?
Mr Spratt: It might well be. We are actually sponsoring members of the Automotive Skills Council, which is the body which sets the standards for training across the industry, and we are working with them for standards for our own part of the industry and I understand that there is some move to actually make sure that Automotive Skills Council and the Automotive Academy work in close liaison to make sure they do not duplicate each other or miss something out.

Q321 Chairman: Such has been the concision of your replies we have got through the questions very well. As I have said already, please do not think that the shortness of the time we have been with you is any indication of the low priority we give to it because we are very conscious that once a car comes off the forecourt that is when Joe Public gets involved.
Mr Spratt: That is when we all feel it!
Chairman: Can I say thank you very much. If we need to get back to you maybe on some of the skills and training issues we might follow up a couple of points there. Can I just say thank you for your time and patience this afternoon in waiting.

Tuesday 4 May 2004

Members present:

Mr Martin O'Neill, in the Chair

Mr Roger Berry
Richard Burden
Mr Michael Clapham
Mr Jonathan Djanogly
Mr Lindsay Hoyle
Linda Perham
Sir Robert Smith

Witnesses: **Mr Matthew Carrington**, Chief Executive, and **Mr Alan Pulham**, Franchised Dealer Director, Retail Motor Industry Federation, examined.

Q322 Chairman: Good afternoon, gentlemen. Can I welcome you here once again. It is some years since you were last here and, in the intervening period, car prices have fallen. What is the reason for that? To what do you attribute the fall? The last time you were here, we were complaining that car prices were too high as against other European countries. They seem to have fallen, but the impression we have is that we are still a wee bit higher than elsewhere in Europe. Is there any advice you can give us on these positions?
Mr Pulham: Since we last met, I think you were perhaps, without being patronising, a catalyst for something that started around about that time which was followed by the New Cars Order which came out from the then Secretary of State. Rapidly following that, we saw a movement in UK car prices. Most came down something in the order of 10%. This move was made by the vehicle manufacturers in response, I think, to criticism, in response to the New Cars Order and in response to the vast number of parallel and grey imports that were coming into the country at that time. Since the reduction in price, we have seen a new car market in this country that has gone up for five successive years and clearly I think the consumer, male or female, is voting with their purse or wallet and buying new cars in large numbers. The growth is predominantly in the retail sector rather than the fleet sector. So, whatever happened seems to have worked. With regard to European prices, I believe we are pretty close now. Out of the 70-odd prices that are looked at by the Commission twice a year, something like 40 UK prices are now lower than they are in some European countries. That clearly was not true five years ago. As a result, the level, particularly of parallel imports, has dropped to the point where one could say that it is almost irrelevant to the industry.

Q323 Chairman: By that, what percentage are we talking about in terms of parallel imports?
Mr Pulham: Probably single-figure percentage, we would estimate less than 5%. There are no formal figures being published that one can access but, by talking to members and understanding where the big issues were previously, it is clearly not happening now. It was premium brands that were being hit the most because you could save the most money. So, BMWs, Mercedes, Jaguars and Land Rovers, despite being built in this country, were clearly being imported back into this country. It does not appear to be happening today to any extent.

Q324 Chairman: Are we exporting cars to parts of Europe from where previously we were importing them?
Mr Pulham: Yes in the case of Northern and Southern Ireland. We had a very significant number of cars crossing the border south to north, up to 25% of the car and light van market was coming in from the south. We are now seeing certain models crossing the border in the opposite direction.

Q325 Chairman: With one gallon in the tank, I would imagine!
Mr Pulham: Only one gallon, yes.

Q326 Mr Clapham: We have been told that there is consolidation in car retailing now. Is it possible to say what is driving that? How is the consumer going to fare, for example? Is there going to be a reduction in competition impacting on consumers or is there likely to be benefits from the economies of scale?
Mr Pulham: Taking the last point first, at the moment, with the way our industry is structured, there is little opportunity—I stress little opportunity—for benefits of economy of scale. Manufacturers set the prices; they only vary prices to the fleet industry; they do not tend to vary them significantly to the retail sector through their dealers. So, the economy of scale is not yet apparent with some few exceptions. The consolidation at the moment I would suggest is having neither a beneficial nor detrimental effect in the marketplace. What we are seeing is some wealthy groups buying out other groups. It is something that has been a fairly regular occurrence in this industry since the war; this has happened before. We have seen high levels of consolidation and then the industry goes through a different cycle after that and changes. It has been an historical fact. At this moment, I do not think there is an issue that will impact on the consumer.

Q327 Mr Clapham: Is it possible to say what is the driver there, just to bring that out a little more?

Mr Pulham: I think the driver is probably the Stock Exchange as much as anything. If you are running a large public limited company, you have to be seen to be doing things and one thing is maybe taking over another business and growing your business.
Mr Carrington: If I may add to that the fact that block exemption has made it more feasible for a large group to buy another group because they do not then have, necessarily, to get the manufacturer's permission to be able to take over the dealerships. So, part of it is being driven by the fact that they can more easily do it now than they used to be able to.

Q328 Mr Clapham: Given what you have just said, Mr Pulham, you do not feel that there is going to be benefit to the consumer from this consolidation overall?
Mr Pulham: Not as long as the manufacturers set the prices in the way they set them today, no.

Q329 Mr Hoyle: Can I just take you on to something that is always intriguing people. What percentage do you get to play with by the car manufacturers as franchise dealers: 15%, 20%, 30%?
Mr Pulham: As a rule, less than 10% is free to play with. Another 6%, occasionally as much as 8% if the initial percentage is lower, is based on certain performance criteria. This can be customer satisfaction, it can be premises standards and it can be volume achievement.

Q330 Mr Hoyle: So you have about 10% below list price to play with?
Mr Pulham: Yes.

Q331 Mr Hoyle: Does that include profit?
Mr Pulham: That is potentially but then, if you are going to trade with that, that is what you are getting from your manufacturer.

Q332 Mr Hoyle: That is the part I am more interested in.
Mr Pulham: That is not his profit, that is his trading margin.

Q333 Mr Hoyle: Basically, from the list price, you will achieve below 10% on average?
Mr Pulham: Yes. Most dealers retain somewhere between 2 and 3%.

Q334 Mr Hoyle: I have noticed from your evidence that, quite rightly, you say that your members are not getting as good a deal as the fleet purchaser.
Mr Pulham: That is correct.

Q335 Mr Hoyle: Why is this and why do you feel that members are being held to ransom in this way?
Mr Pulham: That is an historical issue. The manufacturers right from the 1970s started handling fleet business rather than the dealers and progressively they have taken control of it. Since the advent of benefit in kind taxation and, prior to that, wage restraint policies, we have seen a tremendous growth in the company car market and manufacturers have chosen to manage that market themselves. So, arguably, something like 60% of the market is sales handled by manufacturers commercially. The dealers may physically handle the vehicles but they do not have any interface commercially with the customer until it becomes a service issue once it is in the market.

Q336 Mr Hoyle: I was speaking to somebody at the weekend about a company that always had a 12% fleet discount and the fleet discount has been increased to 30%. If that kind of discount can be operated to fleet purchases, surely poor old Joe Public out there once again is being turned over by the manufacturers because, if you were to get the same discounts for the fleet, obviously that could then be passed on to the public at large and we could all benefit. However, would it be fair to say that the manufacturer is once again quite happy not to pass on any benefits to yourself and to the public but is happy to keep the sales figures to try and keep in the top ten and that the people who subsidise it are the public themselves?
Mr Pulham: Absolutely. I think you are quoting from our evidence of 1998 precisely!

Q337 Mr Hoyle: And the fact that it still remains so is even more worrying, I am sure you would agree.
Mr Pulham: Absolutely. It is the one thing that has most relevance in changing motor retailing and the relationship between customers and the deal they get. If something can be done with that, a lot of things could start to happen. As long as 60% of the market is controlled by the manufacturer at better terms than the dealer can buy vehicles, then we are not going to have a healthy competitive market.
Mr Hoyle: Yes, that is what is worrying me and the fact that somebody has actually made a percentage kill because they have a better deal with that fleet business and they are taking money out of it as well, and that is obviously at the expense of yourselves and the public out there who could get an even better deal and I think that is the message we must get across.

Q338 Chairman: If I could just go back a couple of points, this process started in the 1970s and, at that time, the way of getting around pay freezes and the like was to offer benefits in kind.
Mr Pulham: Yes.

Q339 Chairman: These have now been taxed but the taxation has not really had the effect of breaking this umbilical link, as it were, between the low price and the manufacturers. Do you think there is anything else that the Treasury could do to end that? Basically, what you are telling us, if I can go back to what you said in 1998, is that those of us who do not buy fleet cars are in fact paying over the odds because of the discount which is given to the fleet companies.
Mr Pulham: That is it, absolutely.

Q340 Chairman: What happens when the person or the company after 18 months or whenever hands back the fleet car to whomever? The man/woman on the road hands back the Mondeo to whom? Is it to the dealer?
Mr Pulham: It can be to the manufacturer, it can be to a leasing company, it can be to a dealer. In many cases, the deal has been struck in such a way that, at the end of the period of time, there is a value already determined for that vehicle, so they know what price they are going to get. They can assess the whole life cost of that vehicle while they operate it as a fleet car. They understand. That is something that the private individual has to worry about because of market forces at the end of the time that they have kept a vehicle.

Q341 Chairman: What is the determining factor in the second-hand price of the form of leased car?
Mr Pulham: Quite often that deal that is originally done with the vehicle manufacturer; it has been predetermined.

Q342 Chairman: So, if I wanted to buy a second-hand car that is 18 months old having been leased, I would pay the market rate which would be perhaps almost about the same price as what was originally charged in the first instance by the manufacturer.
Mr Pulham: It could be even more.

Q343 Chairman: I just wanted to get that on the record because I felt that we just needed to have that spelt out once again because some people who read the reports we make are not that smart or certainly the conclusions that should be drawn from the reports have to be wrung out of them sometimes in ways that we do not always appreciate but, thank you, that is very helpful.
Mr Pulham: You asked a question as to what else could the Treasury do. I am not sure that the Treasury can do anything. I think what we would seek, representing dealers, would be a situation where nobody should be able to buy a car on better terms than the dealer who buys it wholesale. So, if somehow that were put in place, that would ensure a more stable market. In other words, ICI or Nat West Bank could not buy cars on better terms than, say, Reg Vardy or Inchcape could buy those same cars from the vehicle manufacturer.
Mr Carrington: Quite an easy way of doing that of course would be that the vehicle manufacturers could not sell direct to end users, they would have to go through the dealers to sell to fleets. Of course, they would have to give dealers the same price they had given to fleets.

Q344 Mr Hoyle: Unless they own the dealers.
Mr Carrington: Even if they own the dealers, they would have to give other dealers the same price and, the way things stand, they would not be able to sell to their own dealers at a different price.

Q345 Mr Hoyle: But they do.
Mr Carrington: Not to any great extent, we hope. If we had evidence of it, we would create trouble.
Chairman: I think we can perhaps explore this. It may be that, at some later stage, the OFT might be invited in to discuss our findings rather than to take evidence at this stage.

Q346 Linda Perham: Can I ask you how your members responded to the block exemption changes? Mr Carrington, you mentioned in reply to my colleague Mr Clapham about larger groups being able to buy other groups. In general, have your members found that this has been of benefit or otherwise?
Mr Carrington: Perhaps I can start on that and ask Alan to come in on the franchise side. The answer is that the block exemption has not actually created too much of a change as yet. It is creating some changes on the margin, like the ability to be able to buy dealerships without getting manufacturer approval provided that they already have that brand in their dealership group in the company. In terms of other effects, we are rather waiting for them to appear, on the positive side. On the negative side, what it has done is pushed up costs quite a lot. We may get into that but what has broadly speaking happened is that the manufacturers have taken the opportunity of the block exemption to require their franchise network to invest substantially, particularly in the buildings but to some extent also in the training, and they have required people who wish to become authorised repairers, whether they are from the independent side or they are people giving up selling cars from the franchise side, to match that level of investment. Consequently, there has been a negative aspect with the block exemption as well as what we hope is going to be the positive side.
Mr Pulham: Clearly, dealers have gained some powers. Matthew has alluded to the ability to sell their business, the ability to be selective about whether they want to be sellers of motor cars or just repairers and whether they want to perhaps repair several brands of motor cars, so that is an opportunity. October 5 next year, with the removal of the location clause, will perhaps give dealers some more options without having to kowtow to the manufacturers. I think the big impact, as Matthew has said, has been the cost of that and that, as always, must get transmitted somehow through to the end user, to the customer. We are not seeing a market where retailers are having an opportunity to take any cost out of their business. We are seeing them having to add cost.

Q347 Linda Perham: So, it has given you some more freedoms on the positive side but the negative is really the cost.
Mr Pulham: Yes and the difficulty for a retailer who has made an initial investment is whether he is then able to take advantage of the freedoms really, other than to sell his business perhaps.

Q348 Mr Berry: You suggest that manufacturers are still in a position, despite the traders, to set the price of cars and I would like to know how you believe they do that. This time last year, I was looking for a new car. I looked at the obvious websites and I found a vast difference in price for exactly the same car, a few thousand pounds here or there. I was not getting the impression that there was some manufacturer out there determining the market. I had the impression that some were offering good deals and some were offering bad ones. You are saying that manufacturers set the price, but how do they do it?

Mr Pulham: They establish the price at which they sell the motor car to the retailers and, from that, the retailer then has an opportunity to put on to it 5%, 6% or whatever, but he only has a scope within perhaps 5 or 6% to vary that price.

Q349 Mr Berry: In practice, it does end up in some quite significant price variations for the same model, in my experience. I have not checked recently.

Mr Pulham: In some instances, some dealers have been able to take advantage of an element of the New Cars Order that said that manufacturers should offer fleet discounts of similar volumes to the retail sector, which really meant that only the very largest dealers could perhaps take that advantage. In the main, the manufacturers would only offer the sort of models that they were offering big discounts on fleet, which might be low-line models, loss-leader type models. The other thing that is going on in what is now a fiercely competitive market is that manufacturers are putting additional marketing support behind certain cars at certain times because they are all struggling to get a market share. If you analyse over the last five years how the market has changed, you will see relative positions in terms of market leadership have changed. Overall, it has tended to be the volume players who have lost out and the premium and the cheaper models that gain because, in many cases, people have realised that the premium model, although it might have a slight cost premium, actually overall because of a good residual value at the end of ownership, is probably a better buy than maybe a volume car that has very little in terms of residual value at the end of three to five years. Then there are other people who have just entered the new car market because of lower prices who are buying at the modest end and that is the end that is growing the most. Minis and Super-Minis seem to be the best selling segments over the last two years.

Q350 Mr Berry: I think you have touched on this but let me be quite clear. Given that you are arguing that essentially manufacturers still determine the price of cars, what do you think should be done about it?

Mr Pulham: If you took out this disparity between fleet and retail and created an open market, then you might begin to see some changes in vehicle prices.

Q351 Mr Berry: Is there anything else?

Mr Pulham: I do not believe so.

Q352 Mr Berry: That is the key?

Mr Pulham: I think that is the key.

Mr Carrington: There is one other thing which does influence but is very much on the margin. It is the way in which dealers are recompensed by the manufacturer for volume. So, if dealers are incentivised to sell certain types of vehicle to a certain level of throughput in a certain period—and it gets quite complex—then their bonus that is calculated, which is a significant portion of the margin for a dealer, can vary quite substantially if you hit those targets or you do not hit those targets. So, to some extent, the way in which the dealers are rewarded for selling vehicles influences the price at which those vehicles are sold because, if you are a dealer and you are very close to hitting those bonus levels, you really just need to get rid of the vehicle and the price becomes almost irrelevant because the difference between hitting the bonus target and not hitting the bonus target becomes significant. So, it is more complicated than just fleet versus dealer, although that is the biggest influence, there are these other aspects of the way in which manufacturers exercise control on dealers through the profit margin as well.

Q353 Richard Burden: Continuing on with that for the moment, given what you were saying, putting fleet and retail together and saying that the same would apply to both would not necessarily solve the problems for the reasons you say?

Mr Carrington: It would go a long way. It is by far and away the biggest influence but there are second order influences which are to do with margins of dealers.

Q354 Richard Burden: I was trying to think about how that could be regulated because earlier on you said that one way of regulating that would be to say that manufacturers could not sell below the price available to dealers, which would effectively mean that somebody who was classified as a dealer would end up in a sense collectively cornering the market on the sales of new cars, whether fleet or retail. If that were to happen, what would there be to stop the dealers themselves doing what the manufacturers are doing? That if fleet orders were potentially more lucrative because of volumes and so on, would you not actually end up transferring, if you like, the alleged price fixing from the manufacturers to the dealers doing exactly the same thing themselves?

Mr Carrington: No, you would not, and there are two reasons why you would not. One is that there are a lot of dealers and, as your colleague Mr Berry said, people go on to the internet and find the best price. So, there is a lot of competition on the dealer side and it would be very difficult for dealers to operate what is effectively a cartel, which I think is what you are describing. The other thing is that, as my colleague Mr Pulham has suggested, as at 1 October 2005, it becomes possible for dealers to sell in each other's territories under the block exemption regulation and that would mean then that, if one dealer was selling at a higher price than another dealer felt he could sell at, the cheaper dealer would take all the business away from the more expensive dealer.

Q355 Mr Berry: What I was getting at is if particular dealers who would have quite a lot of muscle in the marketplace were able to get a kind of critical mass of orders and line up a number of big fleet orders, that is where their money would come from and actually they may end up finding that that was actually the most lucrative way of doing it and therefore there would not actually be any great incentive to offer retail customers the same deal even if there was no cartel.

Mr Carrington: I think that, if they did not, there would be other dealers who would. So, I think it would balance out. No dealer is that dominant in the market in terms of market share that they could control the market to any extent, even if you added in the fleet business (because I think you will find that the fleet business was spread fairly evenly across the country and therefore would be spread across many dealers), so I do not think you would find that any dealer would be in a market-dominant position and therefore be able to effectively control the price. I do not think that would happen.

Q356 Richard Burden: Can we just move on with the after market because it has been suggested that changes in block exemption actually end up being underlined in the after market through limits on access by manufacturers to certain technical specifications and setting unreasonable requirements or what seem to be unreasonable requirements, on achieving authorised repairer status. How do you feel about that? Do you think that is a real problem?

Mr Carrington: I think it is potentially a real problem. The situation, if I can answer the authorised repairer point first because it is something we touched on earlier, comes down to the amount of investment that the manufacturers are requiring people aspiring to authorised repairer status to put into their operation and that is very much the level of investment or exactly the level of investment that they are requiring the franchised dealer to put into their operation. What they have done is increase the investment level and they have increased the investment level in the workshop just as they have in the showroom for selling the new cars. Consequently, our estimate is that, for an independent garage wanting to become an authorised repairer, they would find it very difficult to make it economically viable in most cases, particularly when it looks as though it would be quite difficult if you are an authorised repairer to cover more than three brands or three marks of the vehicle because of the nature of the way that, under block exemption, the manufacturers control what you put in your workshop. I think that the problem is one of level of investment in that and consequently we have seen very few people applying to become authorised repairers where the manufacturers do not want them to. There are some manufacturers who are very keen to have authorised repairers because they have gaps in their service and repair network and they have been encouraging people to become authorised repairers and there they have kept the investment levels down to low enough levels to encourage people to do it. Where manufacturers have not wanted that to happen, it has not happened and there have not been the people wanting to become authorised repairers. Therefore, you could say that the block exemption is not working. On the other question of access to technical information, we have done a lot of work on this as you might imagine and I think our belief is—and it is still a rather confused picture—that the manufacturers are all making technical information available. It is not the access to technical information that is the problem. The problem is the cost at which it is accessible. In other words, what you have to pay to get the information principally off the manufacturer's website. What sort of level of training do you need to understand the technical information? In other words, how accessible is it to somebody with a normal level of training in the motor industry? The third problem is that there is no standardisation between manufacturers as to how they present the technical information. So, you may go into one manufacturer's site and, because you understand that manufacturer, you can understand the technical information on his site but you can go and look at exactly the same equivalent technical information on another manufacturer's site but it is presented in a different language and, by that, I mean different terms being used in English for the same parts, and you would not be able to make immediate use of that without additional training. So, there are problems really at a level below manufacturers saying, "We are not making the information available." They are making the information available, it is just not in a readily useable and affordable form.

Q357 Richard Burden: Would it be possible, on the question of investment that you raised first, for you to maybe provide us with some more information of examples? I am sure we would want to draw a distinction between where, in a sense, investment is being required to drive up standards amongst repairers and investment that is required in order to ensure that somebody gets vehicles to repair and somebody does not, that is just kind of cosmetic. I think it would be useful to have information as to how much each of those are both good practice and less good practice.

Mr Carrington: We can provide you with what we have. As I say, it is very patchy still and because there are so few garages that apply to become authorised repairers, the information is not clear in many instances, but we do have some and we will willingly let you have what we have.

Q358 Sir Robert Smith: Following on the repairing theme, the CarWise scheme is supposed to give consumers a better deal in car servicing. Is there not a sense that, if the RMI is involved, that you are acting as gamekeeper and poacher? Do you think it would be a more authoritative scheme if it were seen to be run by an independent organisation?

Mr Carrington: It is self-regulation and it was set up to be self-regulation and that was the purpose behind it and there are some good reasons for that, but it is actually independently controlled in any case through several ways. One is that we have an independent scrutiny committee which monitors what the standard is that garages have to achieve, it monitors the performance of the garages, it controls our mystery shopping, our inspection of garages, and indeed can call for any data that they feel they need to be able to justify that the scheme is working. This independent scrutiny committee is composed of a consumer representative the National Consumer Council and Trading Standards Officers, the independent element would be the majority on the scrutiny committee and then we have some people from the industry to give the technical expertise to be able to understand what is going through. So, it has a big level of independence but it is also of course monitored very closely by the OFT because what we are actually implementing is what we hope will be an approved code. It has been granted stage one. We hope that stage two under the OFT approved codes regime will be granted to us before very long. So, the OFT will monitor very closely what we do as well and of course it would be a disaster for CarWise to lose OFT approval. Consequently, if the OFT felt they were unhappy and removed the approval, we would be in trouble. The great advantage of self regulation over statutory regulation or some form of licensing or whatever it is that is in place is twofold. One is cost. If I can give you a comparator of that, at CarWise we are charging—and there are discounts—£100 per outlet/garage for members of the RMI to sign up to CarWise and £525 for people who are not members of the RMI because there is an overlap in how their subscriptions are paid. The franchise networks and those independent garages that sell cars are currently having to come to grips with the Insurance Mediation Regulation. From the Financial Services Authority. This covers one small bit of their business which essentially is selling insurance which they do as an adjunct to selling motor cars. We reckon that is going to cost each garage somewhere between £3,500 and £4,500 per annum and indeed some estimates have put it close to £8,000 per annum. There are a lot of good reasons for that but you can tell the difference between the two in terms of cost. Self regulation ought also to be more effective because what we have is people looking at these garages, what they do as garages and what they should do as garages who will then be able to say, "Look, forget what the letter of the law says on this, actually what you are doing is not what you should be doing for your customer and you had better put that right or we are kicking you out of the scheme because we have the flexibility to do that."

Q359 Sir Robert Smith: Is that the main penalty?
Mr Carrington: The main penalty—we do not have the legal power to fine people—is that, if they will not put their house in order, they will get kicked out of the CarWise scheme, they will no longer be able to show the logo for CarWise and, probably more importantly, the OFT logo (the approved codes logo). Of course because CarWise is being done in conjunction with trading standards officers in their locality, they will be taken off the Trading Standards approved list and the trading standards officers will be notified that this is a garage to keep a watch on. And there will be all the local publicity as well. So, there are big penalties in terms of trying to run a successful garage if you are struck off the list.

Q360 Sir Robert Smith: At £100 a garage, what sort of hit rate would there be in terms of . . . ? How are people going to be caught? If there is going to be mystery shopping, presumably there were complaints.
Mr Carrington: There are three ways that people are caught in this. There are two ways in terms of inspection and mystery shopping. We inspect half the garages every year. So, in a two-year cycle, every garage will be inspected. We have agreed statistically with the OFT that mystery shopping has to be done to 11%, slightly bizarrely for us non-statisticians! So, we will be mystery shopping at 11% and we will be mystery shopping those garages that look as though they are failing in addition to that. We also run, which we have done for the industry for a very long time, a national conciliation service, an arbitration service and a disciplinary service. Part of CarWise is that it will be made much clearer to the customer how they can access the conciliation service. Consequently, there will be customer feedback slips and these will trigger inspection. Where a customer complaint comes in, that will trigger us going and looking at that garage again in greater detail. So, there are three routes in. Clearly—and I make no bones about this—some garages will from time to time carry on not giving the perfect service. We just think that we will catch them, we will stop them but what it will do principally for the motorist is that they will be able to identify which garages have committed themselves to this level of service as opposed to those garages which have basically said, "We don't care."

Q361 Mr Djanogly: Levels of service are also to do with who is doing the servicing and the Consumers' Association has expressed concern about the poor standard of training for vehicle technicians. Is the RMI taking a lead in this area?
Mr Carrington: Yes, we do. We have the largest apprentice training scheme in the motor industry in our subsidiary called Remit. We have something around 7,500 apprentices under training at any one time. Indeed, I think it is about the second largest apprentice training scheme in the country. So, we are deeply into that. We also encourage our members to increase the post-apprentice training levels of their technicians. We are also very involved in the new initiatives that were set up just recently, in fact bringing together other training initiatives, called Automotive Skills Limited, which is the sector skills council for the retail motor industry. The RMI was very heavily involved in getting approval from the sector skills development agency for it to be established. We are very keen on technician training and technician qualification and, indeed, are in discussions with the Institute of the Motor Industry who are one of the awarding bodies for technician training on their proposals to have a form of

technician registrations, so that there is a validation of the continuing professional development of technicians in the motor industry.

Q362 Mr Djanogly: From what you were saying, does that mean that the quality of technicians is improving?
Mr Carrington: It is improving. It is improving we believe considerably. The manufacturers put a huge effort into training technicians as well, it is not just the retail side itself. With the increasing complexity of modern cars and the technologies which modern cars use which they did not use before, technicians do need continual retraining now which perhaps 20 years ago they did not. So, there is a major effort going into that.

Q363 Sir Robert Smith: You were talking earlier in answer to Mr Berry's question about the market and Mr Berry talked about shopping around for prices, but my limited experience of buying through dealers is that the price on the screen bears no relation at all to the price a few minutes after you have started talking about possibly wanting to buy the car. I just wondered, do you think there is any move towards a more transparent pricing system or is it really a question of negotiating a deal?
Mr Carrington: I think it is a pretty transparent system already. Clearly, you can do deals. They are not called dealers for nothing!

Q364 Sir Robert Smith: It is the speed at which the price drops.
Mr Carrington: It depends on what else you are doing as well. If you are going in to a dealer and you are saying, "I just want to buy a car", clearly the dealer is looking then at that transaction to make his profit. If you go in there and say, "I want to buy a car but, by the way, I would quite like to take out some consumer finance as well to cover it", the dealer will make some money on the consumer finance probably. So if you are getting consumer finance as part of the package, and if you are then buying all the various insurance related products around the consumer finance, you might also be putting money into the dealer's pocket by doing that, in which case the price of the car may come down because the dealer is looking for a return on the car and will be looking at the whole deal as a package. Also, some dealers are hungrier to do deals in that particular month than other dealers, as I was saying earlier, and some manufacturers may well be doing incentive deals, it will change literally from day to day. So, you may find that you walk into a garage and you just hit lucky. Equally, you might want to shop around.

Q365 Chairman: So, in some ways, the old idea of going in with money and saying, "I would like to buy a car, there is a wedge", they will say, "I am sorry, we don't want your money, we want to sell you overpriced financial assistance plus a meaningless insurance. You will make us a lot of money but you will end up with a cheaper car."
Mr Carrington: I think that if you went in as a consumer and bought overpriced finance and meaningless insurance, you would be better off going down to the bank and saying, "What deal will you do for me to finance this car?"

Q366 Chairman: That is what I used to do and then I used to go to them and say, "You are getting the money right away off me, so why can't I get a higher discount because I am providing the money?"
Mr Carrington: That is right and you may well be able to negotiate it as a package, if you go to the combination of a bank and the dealer, and you may be able to get a cheaper deal. On the other hand, you may not. What I would say to you if you are buying a car—and I think it is what most of our members would say to you—is, go and look at what your options are but do look at the total price of what you are buying, not just at the individual elements of it.

Q367 Chairman: One thing that I was not quite clear about is that you said to Mr Berry that there is a 10% margin that you have a degree of discretion on and then there is maybe another 2 or 3% that you might get but, on top of that, there is some volume discount. So, if you sell 40 Peugeot 306s, the garage will get money for that but that is a kind of discount that probably, until you are down to about the last two at the margin, the customer will never see the benefit of. Would that be right?
Mr Pulham: That floating margin that you referred to includes the trading money.

Q368 Chairman: So, that is the 2 or 3%?
Mr Pulham: That is the 2 or 3% and it can be more than that in some franchises.

Q369 Chairman: It is just that I was not clear. So, there is the 10% and then there is maybe 2%—
Mr Pulham: 10%. In some instances, it might be far lower than that and the floating element might be bigger.

Q370 Chairman: But it is rarely more than, let us say, 15 or 16%—
Mr Pulham: Very rarely. In fact, more commonly, 12% in total.

Q371 Chairman: As against the 30% that you would say would be the upper limit for a fleet deal.
Mr Pulham: No, 45%.

Q372 Chairman: A factor of three almost, you might say.
Mr Pulham: Yes.
Chairman: That is very helpful and that is a good start to the afternoon. Thank you. If there is anything else that we need to come to you for, we will do so.

Witness: **Professor Garel Rhys**, Cardiff University Business School, examined.

Q373 Chairman: Good afternoon, Professor Rhys. It is a wee while since we have seen you. You have appeared on both sides of this table for this Committee over the years and therefore I will not say that it is surprising that you are painting a reasonably optimistic picture of the automotive industry, but perhaps you could just rehearse for us what you see as the strengths of the UK industry and perhaps the downside, where you see our weaknesses.

Professor Rhys: I think the strength of the industry is that it is still a broadly-based one. We make a very wide range of products. We are good at upmarket cars/executive cars. However, the majority of production is actually for the mainstream market, Japanese producers, Peugeot etc, and it is only really the Germans and us in Europe that have those two strings to the bow in quite that way. So, that is a plus. Also, I think that we still have a robust component industry and systems industry and R&D. The threats are that the level of production is still lower than it was in 1999 but the industry in a sense is marking time although hopefully it is on a long-term trajectory. The 1990s were good but with the market turndown in 2000, production turned down considerably in the UK.

Q374 Chairman: Before you go any further, can I just ask you, how do you define production given that, for example, Ford only assemble vans here but they also do engines. Do you have a kind of yardstick of output which is separate from the number of vehicles that come off the end of the line or are you doing it only by the one yardstick?

Professor Rhys: We look at the vehicles that come off the end of the line but we also try to use figures from the component or supply sector, it is so homogenous. So, we take the production of engines, if you like, as a proxy for the health and robustness of the supply sector into the industry. It is pretty imperfect but the trouble is that components are so heterogeneous and the data is not nearly as good as the data for vehicles and the data that we managed to put together on engines. So, those are the two main yardsticks that we use. One of the issues that we have to take on board is that for many, many years, it is not so much a British motor industry but a motor industry in Britain. It is foreign-owned and therefore nobody is going to do us a favour. We do not have Supervisory Boards saying to the company, "No, you cannot invest in Spain, you have to invest in Germany." Also, the market itself, although it is a record and this year it is likely to be another record, well over 2.6 million, it could even be 2.7 million this year, over 80% is foreign penetration. So, the link between British production and the British vehicle market is now a pretty tenuous one. In the 1980s and up to the early 1990s, the industry would say, "Reduce taxes or give us easier credit conditions. Get the market bigger and we will make more vehicles for you." Now, frankly, you are doing more for Stuttgart or Turin or factories in Germany. What we have is an export-led industry. 69% of production is exported, that is the strength, but it is also a challenge because it does mean that you do not have that big base load at home. So, 69% is exported and the recovery of production since the early 1990s is export-led, it is not actually the penetration in the domestic market, and this is a bit of a disappointment because, with the new investment that came into the UK via the Japanese etc, it was hoped that we would be able at least to push back imports a little, but it seems impossible. Last year, exports went over 80% for the first time and it had been hovering amongst the top seventies and it stayed there this year. When you look at some of the gaps in our production in very crucial areas, in Britain, for instance, in 1999–2000, the super mini sector was about 25% of the British market and now it is 32% and yet we only really make one mainstream super mini, the Micra. There are others: the Mini itself, made in Cowley; that is a sort of super mini, and the Rover 25, and the City Rover of course comes from India. So, we only have one product really, one big product, in that sector that is burgeoning. Another sector is within the light/medium area where huge growth has occurred in the small people carrier, the European size people carrier, not the Renault Espace, that is too big, the engines are too big, you did not want that, you wanted the sort of vehicle that was really highlighted by a vehicle like the Megane Scenic, a European size people carrier. In the period of four years, the light/medium sector has seen that sort of variant go from 6% of the market to nearly 25%. So, one quarter of that segment. We do rely upon that light/medium segment and the other medium segment, so we do tend to have gaps there. The other area of weakness is, frankly, commercial vehicles. It used to be our huge strength, but now we are effectively a van maker plus—and it is still there and it is still one of the most efficient plants in the world and continues to get awards—the Leyland Daf assembly plant in Lancashire. Also, of course, we do make fire engines for Dennis, Optare makes buses in Leeds and hopefully Dennis will continue to make buses as well. Apart from that, there is very little and it means that it has a big impact in the balance of payments. If you are buying a heavy truck, something around £80,000 before discount, almost invariably this vehicle has to be imported. So, there are strengths but there are some weaknesses and there are some highlights for the future which do not look too good.

Q375 Chairman: That is a helpful introduction and I think that a number of my colleagues will want to come in on issues of import substitution and things like that. Can I just dwell for a moment on the one part of the UK car industry which is still UK owned, MG Rover. We took evidence from some of the senior management team and I think it was almost inevitable that we would be looking at some of the financial arrangements, but what did come out and perhaps you could maybe confirm or contradict this, meant that the impression I had was that, in the first instance, there are no new UK models coming through at the present moment. There are variations on existing models but there is not something you can seize on and say that it is, not perhaps the new white hope because that would be over-egging it, but there would be some. Secondly, that the structure of the company was such that a number of the other elements could exist without car manufacturing and assembly if that were the case. Thirdly, that there were prayers and wings identified as far as possible ventures in Poland. There has been the Chinese option for some years and it does not seem to be getting any closer, and then there is the Proton issue which I have to say that our experience in Kuala Lumpur suggested that certainly Proton did not have very much to say to us and Lotus had even less. So, there is a sense in which there may well be a car sales element, there may well be a spare parts element, there may well be a useful property development side of things but, as it were, what you would have regarded as the core of MG Rover's operations—the design, development and manufacture of new models and replacement models—did not seem to be quite central in the way you would have thought a realistic possibility for development and expansion element should be there. I am sorry that I have taken so long putting this point, but would you have the same anxieties that I have tried to indicate?

Professor Rhys: Up to a point. In some ways it is remarkable that a company the size of MG Rover, which is actually just one plant—it is like saying there is a company called Ellesmere Port, if you like—is even contemplating trying to introduce a new car. Up to now it has been repackaging the existing vehicles, doing a lot with the suspensions, and so on, but there has to be a new product—this is just holding the line. The question is how new is new? In the motor industry the marketing department projects something that is very new and the engineers know there is a lot of carry-over from something else because that is the only way you can afford to do it. The new product that they can do on their own, and the only one that was ever feasible, was the light-medium car—the car that has slipped from this year to next year. It will use the 75 platform, but that is commonplace in the motor industry; you can use a platform over a number of different cars as long as that platform is a very efficient. A platform of this nature is simply three pressings underneath, of the floor panel, which accounts for about 40% of the body tooling costs. If you can, therefore, use that over various other vehicles you have got a chance of actually getting a new car which, otherwise, probably you would not. That product has slipped; it was supposed to be in the market this year, in a month or so's time, we are now going to see it—so it seems from the evidence they gave you—towards the end of next year, so they have to hang on longer. That is the only new product that they can do on their own, because to succeed that car must be introduced and it must be a success in the marketplace—you and I must want to buy it. Also, there must be a raft of joint ventures around the company because a company of this size is an anachronism; it certainly does not survive in the motor industry; it is a single-plant company, to all intents and purposes; they are competing against multi-plant companies which are, basically, multinationals. How can they do that? How can, with one leap, the hero be free, so to speak? It is the joint venture route. Joint ventures allow you to get into bed with other vehicle makers who themselves have other plants, so it is a form of a multinational operation. It is a secondary form because it is clearly a company you do not control, and I think what they have been trying to do is to find companies that would not dominate them because there are all the usual suspects—the Volkswagens of this world—but MG Rover will be just a tiny company; it would be like a partnership between a Hippopotamus and a sparrow—it would not be equal by any stretch of the imagination. So try to find companies that are about the same size as you and have the same interests as you. That is not easy, but without those joint ventures there is really no future because you simply will not have the volume to start unlocking some of the economies of scale that your big rivals enjoy as a commonplace. In terms of the structure of the company, in some ways, I think, there are parts of that company that could survive without cars. If you look at the Powertrain division, 90% of the engines actually go into MG Rover cars that have been produced. There is not really a business there that would be viable without MG Rover. The finance company, again, I think, probably, over 90% of the new finance that that company underwrites are MG Rover Cars. It is interesting to look at companies that have big finance arms and see what the financial industry has done in terms of giving them credit ratings. If you look at GMAC, General Motors credit company, it has exactly the same rating as General Motors itself. The market does not see this as a more secure company, because even with GM—and GMAC being a well-established finance company—over 85% of its payback is General Motors product. The same thing with Ford. The only slight difference is with French companies where the rating of the finance arm is a bit higher but that is because the finance industry in France is so regulated that it is not entirely competitive, so those arms are a little bit more secure. So I do not think, really, there are these companies that can survive on their own. So it is absolutely crucial that the car company does succeed, because I do not think the rest of the edifice would have much of a future without it.

Q376 Chairman: At the moment, would you say, in the light of your experience, that these deals which have been mooted are actually in the offing? Or do you think it is still wishful thinking?

Professor Rhys: The negotiations are taking place, but they have still not been brought to a conclusion. It is like the car itself; that has not been brought to its conclusion. However, as far as I can gather, the negotiations in China are still going on very seriously. And they do have a chance because the Chinese market is a very curious one, that everybody knows it doubled last year and the first mover has an amazing market share. Volkswagen has over 30% of the Chinese market. The year before they had 40% but 40% of one million is less than 30% of two million, so they are as happy as sand-boys. Number two is General Motors, with 9%—a huge gap. Then you have the 5s, the 6s and the 7s, and there are 80 or 90 enterprises in China that have aspirations to be part of the motor industry. So there is no shortage of suitors asking MG Rover whether they would be the ones to be taken up to the altar and the relationship consummated, so to speak. I do believe there is something reasonable going on. The interesting one, again, is Poland. That depended upon the Polish Government making sure that there were no liabilities that would then end up on the books of the new venture. Again, it seems, from what Polish journalists are asking me, that that is on the verge of occurring, so the debtors and the Government are now in line—

Q377 Chairman: That might be a different type of arrangement, might it not, in the sense that it is the purchase of a plant for the production of 75s?
Professor Rhys: Yes, it is the purchase of a plant. There is no money to be put in as such, I do believe, but what will happen is as production occurs there is almost the internal royalty going then to the company. They do not have any money to put in—they recognise that—so it will be virtually self-financing as it goes along. To start with these are going to be simple boxes coming in from the UK with a very high British content but, I suppose, inevitably, the Poles will want the content to start increasing. That is a different project. The Proton one is a bit of a mystery because they talk about two extra platforms, and so on. Does that mean that they will plug into the 75A platform and the 75 modified platform or is there another one coming out of the ether because the one area that MG Rover cannot go on its own, because you need about 500,000 cars a year to have a fighting chance to make any money, is the super mini. They are nowhere near that in total production. So would Proton do that for you? Probably not because Proton itself is only about 200,000 units, so that does not seem to be a route down towards a super mini. I think, possibly, they would take the risk of doing it with a Chinese company, but that remains to be seen. At the moment it is more for the future—Yeti projects if you like; everybody has heard about them but nobody has yet seen them. Hopefully, one day, all will be revealed. I do understand from many of the machine toolmakers that orders are now pouring in from MG Rover for the car to be made next year. So it does seem as if some buttons are being pushed.

Q378 Chairman: So, regardless of the legalities or otherwise, you might say that a car plant in China is going to produce Yetis? I just wanted to get your view on this because it is part of the UK car industry that we have looked at and, perhaps, we were open to the criticism that we spent more time on the financial arrangements. I think these points were, perhaps, somewhat lost, although they are in the oral evidence as given by the company. It is useful to have some alternatives.
Professor Rhys You got some nuggets out of that, actually. Reading the oral evidence, there was a lot of stuff there and, of course, the attention had gone for the red meat stuff at the beginning, but there was a lot of very interesting information there which you could actually put together with other things.

Q379 Mr Clapham: Professor Rhys, I am just looking at Table 2 of your submission and it is quite clear there that the most productive car plants in Europe are Japanese, and the most productive in the UK are Japanese. Why is this? Why is it that the Japanese retain this high productivity and are able to out-shine the rest of their competitors?
Professor Rhys: They have kept their advantage which they established at the end of the 70s. It is all linked up with lean production; designing vehicles for manufacture, not for style, so that you make the product easily and do not have to rectify it. You train the workforce, you make sure that the plant is laid out in a way that production is going to be maximised; you lay it out in such a way that the components that are coming in from your suppliers come in easily to the line—you do not have things like congestion for the trucks trying to get into the plant, which seems an obvious thing to avoid but when you have not got a plant that is designed to actually take the lorries going in like a herring bone along the production line it is more difficult. So it is all those factors that have allowed them to establish that tremendous efficiency in the 70s and 80s and now they have maintained that. Now they are learning, however, that lean production is not enough; lean production is a necessary condition but it is not sufficient; you want to make things also in very big volumes because it was said in the 70s and 80s by people who perhaps thought the Japanese were even more adept than they were that a smaller Japanese company is more efficient than a big western one. The last ten years have shown that is not the case; most of the Japanese companies have actually had to sell out or become controlled by western companies—it is only Toyota and Honda who are left as 100% Japanese. Also, they must make the products that people really want. In the early days the lean production itself was making vehicles of tremendous quality; they did not break down, no rattles and it was the production system that did it. People then made the mistake that the production system will help the demand curve. It does not. In the end, when we are all good—and, indeed, there is very little gap now in the quality of cars made anywhere in Europe or America—you then go back to the old values of branding and so on. However, the Japanese have not found it nearly as easy as Europe in the 90s as they expected it to; they thought it was going to be easier than this. In the end it is not the Japanese that are coming to the fore, it is actually individual companies. You do not have tremendous industries, you have good companies. So it is not that all the Japanese were good, some of them were. Clearly, not all of them are good, by looking at the debacle of Mitsubishi, but Toyota, at the moment, is the company that is suddenly coming out of the traps and beginning to really increase its market-share in Europe—4%, 4.5%, 5%. It is not the Japanese, it is, if you like, Toyota. Hopefully, from our point of view, it will also be Nissan and Honda.

4 May 2004 Professor Garel Rhys

Q380 Mr Clapham: In addition to the lean methodology and having the market, you have got to have design as well?
Professor Rhys: Absolutely right.

Q381 Mr Clapham: This seems to be one of the things we were saying that the Japanese have failed on, is the design.
Professor Rhys: They are now coming back to it. They are getting their act together, an intake of breath, but it has taken a while. They found that they really did have to open big design houses and centres in Europe to get exactly what the Europeans wanted. World cars are fine, but there are different interpretations of the world car. You can take, if you like, the Japanese interpretation of the world car so high in Europe but to get beyond that you really have to make it more European. If you now look at the styles and designs of these Japanese companies you realise that some of them have nearly learned that lesson and are now going to exert the pressure on European manufacturers that the Europeans thought was going to happen 10 years ago. Hopefully, the Europeans have learnt the lesson and have got themselves into a position that they can now meet that competition because the degree of competition we are going to see in the next 15 years is going to be unprecedented.

Q382 Mr Clapham: What kinds of things have the Europeans taken on from the Japanese—the training, the organisation of the plant?
Professor Rhys: They have taken on board the organisation of the plant, they have taken on board the training, they have taken on board the improvements to their supply chains, they have taken on board the need to actually design the vehicle for the marketplace. That is not necessarily going to ask you want you want—that is a cop-out, really. There is a misunderstanding that when we economists talk about consumer sovereignty it means that the consumer knows what they want. I would not have a clue how to design my shirt or tie or my house or whatever, but what I do is reject things until I find the one I want. So consumer sovereignty is rejecting things until you find the one you want. So what the Japanese have been able to do is to put in someone who has gone along the line and rejected until "Oh, I will have that", whereas a few years ago they would have glided past that and on to something else.

Q383 Sir Robert Smith: You note in your evidence that the UK's better productivity record has gone some way to compensating for the disadvantages deriving from the exchange rate. Is there any quantified estimate of the extent of that disadvantage?
Professor Rhys: Well, it certainly is not the difference in the exchange rate between now and 1997. Given the change in the price of the Euro against the Pound, although the Pound has strengthened a little bit subsequently, the cries of disadvantage seem to have disappeared within the British motor industry. You still have people saying "We do want you to join the Euro" but that is a different issue. There are two issues: one is the exchange rate here and now and the other one is the uncertainty of planning for whatever it is in the future. You have seen it with companies who have reduced the British content of things. The Ford Motor Company did it by getting out of the UK. They wish they had not now because with the Pound going down against the Euro it would have been better to have a higher British content. So being part of the Euro, to some manufacturers, is still a plus. However, you find, amongst the Japanese, that Honda said "We have to take this exchange rate; we are not worried about it." Toyota was in the middle ground and now say, "It is no problem to us", and Nissan, perhaps because of the people from Renault behind them, keep on whinging about it. So you have got a very different view even amongst the three Japanese. You do not hear a problem from General Motors any more; Peugeot feels that they must make a gesture and mention it now and again, but PAG do not seem to worry about it either. So it seems that we could have handled about half of the appreciation of Sterling against the Euro up till about three years ago with the improvement in productivity, and the change in the exchange rate—the net change—that we have seen in the last few years does appear to have knocked it into the long grass. You will still get some people, of course, who unfortunately in the long tail of the component industry, where you do have some very inefficient firms, who might well use this still as an excuse for other problems. That is the key—to try to unravel what the true reasoning is. When you find firms which are efficient then the exchange rate, at the moment, is not at the forefront of their worries.

Q384 Sir Robert Smith: It is interesting that Ford did go so far as to say that they would even like to join the Euro as long as it was not disadvantageous for it. It seemed to be a stability argument.
Professor Rhys: Quite right.

Q385 Chairman: Mind you, that implies that the Euro will be more stable than Sterling.
Professor Rhys: It is not enough.

Q386 Chairman: There is also the point that would it be the case that Nissan, making Micras, make the smallest margin, probably, because people historically have not made a lot of money out of small cars?
Professor Rhys: That is correct.

Q387 Chairman: Therefore, they are looking for every edge that they can get, and if it is of a monetary character relating to exchange then they will identify that as something that they will be taking advantage of.
Professor Rhys: Absolutely. It used to be "small car, small profits". Some people then said "small cars, no profits", but that was not the case; that if you had big production runs which were uninterrupted, in absolute terms you could make a lot of money making Micras. The margin may be small but you make a lot of them so the absolute profit and,

therefore, the return on capital can be quite good, although return on turnover might not be anything to write home about.

Q388 Mr Hoyle: It is always interesting, is it not, that people complain about currency levels and yet a lot of these manufacturers were in Germany where they had the strongest currency in the world and it did not stop them selling cars or producing them. So I always think of it as a bit of crocodile tears in some of the arguments they use. I may be wrong. In terms of research and development, we have had the SMMT before us and they were very concerned that manufacturers in this country are not investing in the levels that they believe we should be and that R&D has fallen away quite significantly. What does it hold for us? Do you feel there is a real danger? Are we missing out especially, say, on engine development and the fuel savings that need to be achieved in order to keep engine production in the UK but, also, in the States, and that we are leading in manufacturing as well as design?

Professor Rhys: Yes, I think this is a great long-term worry. It is a dynamic problem and a long-term one. The area of engines is crucial. If we can unlock this capacity and make 4 million engines we become one of the great engine centres of the world. Really, you do have to have the R&D happening around it. In theory you can do it in Germany or in Italy, you can do it in Japan, but it is actually much better to have this cluster of expertise in the country itself. When you look at the ownership of companies where they have their main R&D it is not in the UK. That is the cost of it. One of the benefits of these companies—yes, they have invested here but they have come from their own countries and they have not transferred R&D. That does not mean to say that we cannot get anything; the fact that design houses have come with some of the Japanese is a plus, but we do have to find other ways, and very innovative and clever ways, to bring together government, universities, the companies, the trade associations to concentrate on a few areas of expertise. There is no point in trying to do the whole lot, you just cannot do that; the industry is not big enough to do that. It is one of the smaller motor industries of the traditional countries of the world. I am very glad it is still here but we must not run away with ourselves that it is one of the front-rank industries—it is not. Consequently, we have to husband our resources and, therefore, concentrate our attack on various points over the wide range of things that other manufacturers and other countries are doing. We are innovative, as a nation. Too often, unfortunately, we do the research which is simple in money terms but the development is what costs money, and very often that development occurs somewhere else. We have to be careful. Engines is a good example: we do have this amazing engine base but you do then get projects where reports say "Let's try to make Britain the centre of expertise for fuel cells and hydrogen." Fine, but in some ways, if that works, you have just destroyed a major part of your industrial base because you have gone away from engines, internal combustion, into something else. That is not joined-up thinking because fuel cells can be made anywhere in the world; they could come in from a country that has lots of sunshine making the hydrogen. So we have to be careful that we do not give wrong messages that we are not interested in the internal combustion engine, we are going rushing after the windmill of hydrogen. Far from it. There is so much that can be done in terms of improving the fuel efficiency of internal combustion engines; you can make internal combustion engines run on hydrogen. That is what BMW wants to do. If they have the hydrogen revolution, they do not see it as fuel cells—an electric BMW does not send the blood coursing through the veins probably. So they do have a vested interest but they say "There is the infrastructure. You would have a pump, you would have a tank". How do you get this into the marketplace so much quicker? Consumers would accept the hydrogen route through liquid hydrogen. It is not going to happen tomorrow, it could be 20 or 30 years, and then you would say "We are working with universities in Sweden on this." 25% of CO_2 comes from transport but 75% does not. In that area, where 75% does not come from, you can switch to other fuels much more easily than transport. A view is being put forward by economists: "Get rid of CO_2 in non-transport areas and then wait for science to come up with the ideas." We are waiting for the physicists; we are waiting for the chemists; we are waiting for the solution. I now talk to physicists who say, "It is not hydrogen, my lad. It is zinc." All right, it might be zinc. That is the trouble; you just do not know exactly what the future is. So how can the industry tick it off. They have to be so careful. They are a conservative industry because you and I are conservative. One of the main reasons for that conservatism was actually brought up in the last session.

Q389 Mr Hoyle: That is my election finished!

Professor Rhys: With a small "c". That conservatism is because you have got an asset, a used car. It is not like my suit, which I will throw away; I expect a residual value. If you buy a vehicle that is very, very revolutionary you are worried that somebody else will say, "No, I don't want that." So that you, as a consumer, will buy a product that you think the market will take on. So the consumer is conservative only because they are looking at their bottom line, or their profit and loss account, and therefore the industry has to be. So many of these ideas could be done in the UK but we really should not be running too far ahead of ourselves, because, frankly, those could be going into avenues that (a) are not going to be put into place for the next 30 years or (b) never.

Q390 Mr Hoyle: Do you think the Government has got it right with their tax advantages if you have your R&D here and that tax breaks are available, or is it just not enough?

Professor Rhys: It is a start. We wish it could be more but, of course, it is controlled by the Treasury. There are countries in Europe that can go a bit further and there are others that can go less, but the point is that the competition increases. The Czechs are going hell-for-leather for high value-added. They are trying to attract design houses to bring the vehicles in; they are trying to attract the R&D. So it is not just the existing countries now, it is actually the new ones in the East that will also be competing. Some of them, for a number of years, will still be able to put together very innovative fiscal packages.

Q391 Chairman: Do you see the balance between R&D conducted by the companies and the R&D which is taking place in the UK universities, and the link between the two? Do you see this as at an appropriate level or do you think that technology transfer from the university to the companies is happening, or is it that, because they are international in character, what might be happening in a British institution is of little interest to a company which is operating out of Detroit or Tokyo?

Professor Rhys: It is getting better at a very, very impressive rate, Chairman. Vehicle manufacturers watch each other like hawks, they worry about what legislators are going to do and they do not want to miss anything that is happening around the world. So they know more than ever what is happening in a particular university. So the links between university and industry, particularly the motor industry, are getting better and better in terms of the funding of projects in the UK and then, hopefully, keeping those projects in the UK to then create the jobs when they start to be put into place. Not all of them will, it is impossible—of course it is—but if you can keep just one of the ten projects that means you will be creating some very interesting, high-value jobs in the future.

Q392 Chairman: How do the car companies keep tabs on technology transfer? We have looked, as a Committee, at a number of other industries and, because of their nature—for example, in the biotech industry—there is a sense in which most people know what everybody else is doing, partly because there are relatively few clusters in the UK and internationally there are not that many. One gets the impression in the car industry that there are a lot of production centres, there are a lot of activities and, for the reasons you have given, the UK position in this is nothing like as strong as once it was—for reasons that we do not need to cry over now because it has happened. On the other hand, we still have engineering departments, methodological departments, and the like, of some international status. Are they capable of making the connections with the manufacturers in the way they might have done in the halcyon days when we had UK-owned car manufacturers in sizeable numbers?

Professor Rhys: Yes, they are. The major institutions are because they have got more and more full-time staff who are geared to try to make sure that there is them and there is the other side. The industry is a network of par excellence; whether it is conferences, whether it is seminars, whether it is the exchange of papers, whether it is the exchange of 'phone calls, they intrinsically know what is going on. Also, there is still quite a movement of people from one company to another. So it is almost like feudalism, the horizontal links and movement of labour is still quite impressive and, indeed, growing at the strategic level in the industry. So, again, you get the information being shared. The industry is not as good as some in coming together to do the projects, but that actually is because they feel so competitive. They are told to be competitive, they are competitive—somebody in Stuttgart is brought up to believe that nobody in Munich knows what they are doing, in some ways—so it is much more difficult for those companies actually then to come together nearer the market. That has been some of the problems that the European scheme have had; trying to ape the Japanese where the Japanese are world-class in competing tooth-and-nail, but not so near the market those companies share all their ideas. It has been much more difficult to actually translate that into Europe. It is a bit easier in America because that was a nation state and they have already consolidated their industry down to a few players. Europe, of course, is inching towards the structure that it would have been, let us say, if the European Union had been created in 1900. We probably would have had three manufacturers making cars by now, so it would have been much easier to have those near-the-market links. So you cannot blame them, in a sense; it is in their DNA to compete—"I am not going to show you our Crown Jewels"—but it is getting better as the realisation comes about that, frankly, you all benefit from this. It is trying to make sure that the product is going to have a market for the next 10, 20 or 30 years. The chances are that it will, because one of the projections we make is that in the next 20 years there will be more cars made than in the previous 110 years of the industry's history in the world. It is only now breaking out from the three "small" places to which it has been confined: North America, Western Europe and Japan. It is beginning to break out. So it is an industry that is actually not going the way of the gas lamp, it is only on the verge of its true, massive global expansion, and we must get part of that. It does not mean to say that all this is going to happen in these new countries, much of the expenditure is going to be in the refurbishing and renewal of plant in the traditional countries, but we must make sure that we are there, up front, showing people that we are still an excellent place to put these products into.

Q393 Richard Burden: I mainly want to ask about the components sector, but if we can just return briefly to the questions being asked about MG Rover, can I be clear on the points you are making on this? Essentially you were making three points in your opinion: firstly, that the picture that is being painted of MG Rover being almost incidental to the Phoenix Venture Holdings operation and could be sacrificed is not a true picture.

Professor Rhys: Correct.

Q394 Richard Burden: Secondly, that the speculation that the new medium car, as it is called, being a smoke and mirrors thing, does not appear to correspond with the fact that orders are being placed in the components sector.

Professor Rhys: Correct.

Q395 Richard Burden: Thirdly, that the long-term future of the company relies on joint ventures, and whilst they have not come to fruition, again the negotiations are real and, again, the talk of negotiations is not a smoke and mirrors operation.
Professor Rhys: No, it is not smoke and mirrors.

Q396 Richard Burden: Given those three things, what impact do you think the constant speculation over the future of MG Rover is having, and the speculation about all those things being smoke and mirrors?
Professor Rhys: There is a danger with your joint venture partner that you are dealing with somebody who is not here for the longer term. That is undoubtedly true. So you have to make sure that what you have to show them is at variance to a view that you are in and out. So it does mean that the task they have to prepare the ground is a bit more demanding, but it can be done. The effect on sales has not been all that great in the UK because if you look at their sales in Britain they have held up quite well. The problem is exports. In 2001 they exported over 40% of production. Last year it was 29%. So the British customer has not really been affected, if that is a guide to it, but it is not helpful. However, I do not think that it has fatally wounded them.

Q397 Richard Burden: In relation to the components sector, your evidence that has already been put out is quite upbeat and quite optimistic about the potential for the motor industry in Britain. However, you do say that the place where the real threat is is the components sector, and that, as manufacturers, the cost of production is hedged against currency fluctuations by sourcing abroad. What do you think the future of the components sector is? Does it have a future? If so, what should they be doing?
Professor Rhys: The components sector does have a future but one fears for the future of a whole raft of individual companies. Of course, the vast majority of those companies—or the biggest cluster of them—are still in the West Midlands. So there are many companies in the West Midlands who are not looking at the future with equanimity, I would have thought, and are seeing that probably they are not going to be able to meet the standards, the product development, of their major customers. That is the worry. Employment has held up remarkably well in the last few years, but there are signs now that there are job losses in the component sector. There have been job losses in vehicle making—Luton and Dagenham increased productivity—but the manufacture of parts for motor vehicles held up remarkably well over the last four to five years. I think when we do get the figures for 2003 broken down to that level (we have not got them yet) we might see that there has been an absolute reduction of 4–5,000 where that occurred. There are other areas, like the manufacture of electrical equipment for motor vehicles, again, of worrying reduction from 11,000 down to about 8,000—not a huge gross figure but in percentage terms. One still is concerned about the traditional component base. The assembly plants, I think, have got a much better future as long as the vehicles in the plants are sellable—it is up to each manufacturer to make sure those plants are safe for the vehicles they make—but it could well be, ironically, at the cost of some jobs or some companies. Some of those component firms are winners, and what they will get are more orders around Europe. I think, possibly, that is one of the reasons why the figures have not shown the decline that people thought they might. It could also be that, looking at the experience in Wales, with the WDA's figures, you have the odd bit of expansion—50 jobs here, 100 jobs there—in a component firm. It does not hit the headlines but all those figures add up to a reasonable sum for our country. Very often that is not taken on board. So it does show that yes, there will be a components sector but I think we will have to really examine what our comparative advantage is within that components sector itself. Just like we cannot make every vehicle, so it seems any more, probably we will not be able to make every component. That is already the case. There are components which we are falling out of. I think the most worrying area is, clearly, the electrical and electronics because, at last, the value of a car that is electronics is now beginning to accelerate. It was long predicted: at the end of the '80s it was going to happen by '95, then '97, then '2000, and now it seems that it is. Perhaps by 2010 on average the electrical component of a vehicle in value will be around 20%. If we make virtually nothing from that it means, by definition, that we are excluded from one-fifth of the vehicle industry. It is in areas like that that we have problems. What you then want to do, if you can, is go hell-for-leather to try to get some inward investment. All right, it might be assembly jobs to start with but from the small acorn a big tree might eventually grow. Or to make sure that we have the R&D (coming back to the earlier questions) coming out of the universities and out of the companies, we have to make sure that there is a small company that suddenly is able to burgeon. We do have them.

Q398 Richard Burden: Who should be doing what to foster that? Is there something specific the Government should be doing that it is not doing?
Professor Rhys: I think the industry has to do it as well. The Government is alert to all of this and will be as helpful as it can be, but we do not always have the funds that are behind the good intentions. I think we get, in many ways, remarkable value for money in the Government's schemes, but sometimes they do look a bit threadbare compared with what is going on in the rest of the world. In fact, I am afraid, it is the nature of the animal.

Q399 Chairman: Are you really saying that in some respects the production of cars is a bit like the production of ships; the fact that the hull is not the important thing; it is what goes into the body? In the past we have tended to have associations with steel and stamping, and that was the bulk of the expenditure, but now it is the electronics.

Professor Rhys: There is certainly an element of that, exactly—ship building, aeroplanes, fuselage, wing, engines. Three big contracts for the systems. Within the vehicle industry the more that you get true systems, true modular construction, it will be various modules that will be the things to look at rather than, if you like, "Where do those pressings come from, where do those engines come from?"

Q400 Mr Djanogly: Is the EU's expansion to the East going to accelerate the problems for British-based operations?
Professor Rhys: I do not think they will. When Spain joined the EC they had had preferential trading agreements on the automotive sector for 15 years. We have had trade agreements with the accession countries since 92/95, depending on the individual country, so *de facto* where the motor industry is concerned they have been integrated in. So we can look at the period from then to see how much has gone into those countries. Although it has been significant—Slovakia has done remarkably well, for instance, and the Czech Republic—other countries have not done as well, or as well as they expected. The Poles have lost out to other countries in that area; it is not just one homogenous group, they are all at each other's throats trying to get that investment. So the amount of investment that has gone in and which seems to be planned for those countries is not a sign of total meltdown in the EU or on the periphery. In other words, Spain, Portugal—and us. Last year, Spain made more cars than they had ever done in their history, and yet they were one of the countries that were supposed to be in the firing line because these new countries are the new Spains because of what they have got to offer—good sites, cheap labour, etc. etc. However, it is more than that; it is human capital; it is know-how; it is making sure the networks are in place, and the systems. Those things have value. The speed with which wage rates increase in those countries is phenomenal. You might have ten years of a window but it closes. In Slovakia in the motor industry the figure is about 4 euros an hour; in Germany it is 34. Well, they have gone too far. France is 22, and we are probably 18, and most of that is actually covered by our net productivity. There are dangers, though, if a vehicle-maker hits trouble. If a vehicle-maker has put new plants in Eastern Europe and in four to five years' time its models are not as good as they should be, and therefore they have got excess capacity, then you start to worry "Where is that excess capacity?" Peugeot are putting two plants in, one in Slovakia and one in the Czech Republic with Toyota; they have 500,000 units of capacity coming out of that and the Japanese will have 100,000 units. General Motors has built a number of new firms making Astras—

Q401 Mr Djanogly: Will they sell most of those cars in the East?
Professor Rhys: No, it will be there and into the West. It will go both ways. Slovakia's Volkswagen plant, I am reliably told by them, exports 99% (when I wrote this the editor of the journal said "Surely there is a misprint" and I had to put in brackets the words afterwards "99%") for importing to the West—the smaller ones they export out. Of course they will be sold there but it will be part of the new EU market. Already the car-makers are anticipating further expansion; they are looking at Belarus and the Ukraine. Ford has been slow, they missed the boat; they thought they were just selling to these countries, and they have not and they have actually failed—they only have about 5% of that marketplace. Volkswagen has 23%, both French have over 10% but now they and Renault are at the forefront and are going to build major plants in the Russian Federation. So within ten years' time those countries might well have, on a product-by-product basis, free trade treaties with us. I think it will not be a problem in these accession countries; already the challenge goes on eastwards.

Q402 Sir Robert Smith: Are you saying that there might be a problem if there was a downturn at all in the car industry but the more modern plant in the Eastern European country might stay open, and they might scale back their plants somewhere else?
Professor Rhys: Yes, possibly.

Q403 Sir Robert Smith: That is long-term?
Professor Rhys: It is long-term. Peugeot's policy is to become a true, global company in its size by unitary growth. They did all their mergers in the '80s, first with Citroen and then the Chrysler inheritance and they admit that on three occasions they thought they had had it; they had bitten off more than they could chew. So they avoided the mergers of the '90s, not because they did not want to merge but because they were too frightened to do it, but they still want to be one of the big makers. So they are building their own plants. So they do not really want to shut a plant, but if suddenly the market turned against their product then they would have, say, 300,000 units of excess capacity—what would they do? Would it be our plant? Would it be one in Spain? Would it be one of the new plants? Unlikely, probably, but you can never guarantee it. The truth of the matter is that in every decade since the beginning of the motor industry in Britain a plant has closed. So we have had the plant for this decade, hopefully—Dagenham—but, on the other hand, the decade was '45 to '55, so this decade ends in 2005, and then it is open season again. On a statistical probability it is a racing certainty that a plant will close, but hopefully the economics will contradict that.

Q404 Mr Berry: Professor Rhys, you referred, very briefly, a few moments ago, to various government schemes to support the industry. Could you say a bit more about that? Are these schemes at all successful?
Professor Rhys: Yes, I think they are. The schemes in terms of tax breaks, the schemes in terms of working with the industry and the DTI and the SMMT forum, bringing the best practice into companies—I think that has been world-class and has been used as a template for other industries. I think, also, to be fair, schemes like inward investment schemes, going for some of the best companies around the world,

which is an unheralded programme but one, of course, that has added up over the years. Schemes whereby you are trying to help with particular product areas. Schemes where you are trying to unlock all the talent and bring people into one virtual location—the automotive academy, if you will. All of these things, I think, are very impressive, and the sort of schemes which are the ones that are going to be allowed in the European Union in the future, where Brussels tries to save the taxpayer from the largesse of their rulers, so to speak. So you really have to find very cost-effective ways of doing things and really unlocking the talent that is there and, also, showing people as shop windows. At the moment, one is conscious of the Government, the DTI and the Foreign Office, pushing our performance-engineering side. We really have a Silicon Valley in the automotive industry, one is the competition side of the industry—motor racing and so on—and the infrastructure behind it making engineering, and the other one is the design houses and the design courses. The two university courses are over-subscribed, with a tremendous quality of people, and those people could be used far more. They should be our ambassadors, even if they are not British they were trained here. The British do tend to be a bit self-effacing about this.

Q405 Mr Djanogly: You talk about cost-effective measures. I think the term used earlier was "threadbare"; that the resourcing in the UK was threadbare compared to what happens in some other European Union countries.
Professor Rhys: Not the EU countries, further afield. The days are gone when you could really put together big government schemes anywhere in Europe and put public money behind it. If you do you are in danger of falling foul of some sort of law or additionality rule in Brussels and it is undermined.

Q406 Mr Djanogly: That is the obstacle; it is not the failure of government to recognise a sound economic case for investment in these industries?
Professor Rhys: Not any more. I think the motor industry forced government and everybody else to recognise that they had turned themselves round; that the industry, in many ways, was synonymous with all that was wrong about the British economy. Suddenly people realised this is all that is good.

Q407 Mr Djanogly: Finally, how do you regard government initiatives that support the industry in the UK as compared with the rest of the European Union?
Professor Rhys: I think they are innovative, I think in terms of effectiveness they are just as good but I think, perhaps, we still want a few extra schemes and for them to be more wide-ranging. In detail we do not really have much to learn from what is going on across the Channel.

Q408 Mr Djanogly: Are there any particular schemes that you have in mind when you say "a few extra schemes"?
Professor Rhys: I think in terms of looking at the new technologies. Not picking winners because that is drilled into our mind we cannot do that. That is not the point, that is not what you do; you try to help lead the myopia out of the market because sometimes the market takes too short a view, it does not look at the long term. When the Singaporean Government is trying to help that is not picking winners, it is trying to create the climate by which new ideas can burgeon, whereby people of like mind can be brought together with some, again, innovative financing which need not be great but makes sure that you really put your finger on the pulse of what is occurring in the generality of the economy and you say, "Yes, this can actually be applied to manufacturing", perhaps in general but certainly to the automotive sector as well.

Q409 Linda Perham: You touched earlier on the decline of the commercial market sector. What are the reasons for that?
Professor Rhys: We were the strongest commercial vehicle maker in the world until about the early '70s. There is a whole series of reasons. One, the British Government allowed the exclusion of the commercial vehicle industry from the Kennedy round of tariff reductions in order to allow the restructuring of the commercial vehicle industry in France and in Germany and in Italy, who were frightened of Bedford and Ford and companies like that. So we were kept out of the EC. In the early part of the 70s the tariff on cars fell from 22 to 11, it stayed at 22 on commercials and that is where the common external tariff still almost is, at 20. That meant it was impossible. So we were excluded from the market at that time. Then British Leyland was formed and Leyland Motors, which was a world-class operation, became involved in the organised chaos of the car company, and instead of the funds going back into the trucks, which it should have done, it was cross-subsidised into the cars. The cars were supposed to succeed, and they would pay the truck company back. It did not happen, because the car company did not succeed and the money just disappeared down the drain. Then the smaller makers were caught out as the tariffs fell and as competition intensified, and it was impossible for the small makers who had lived by putting together other people's engines and gearboxes—Atkinson, Foden, ERF, they have all just gone, the last ones. So there was a whole series of reasons why we lost those world-class heavy commercial vehicle companies. The last one we have left is the legacy, actually, of the Ryder rescue of British Leyland because the building of this brand new assembly plant in Leyland was part of it. That plant has a two-shift capacity of 34,000 units. So it is working at full single shift but if PACCAR finds they want to make more vehicles there—it is DAF's biggest plant, they make more DAFs there than they do in Holland and Fodens are still made there up from Sandbach—that plant can show what can be done. However, it is an assembly operation; the engines are not made there, some might be made in Britain if a Foden has got a Cummins engine in it but most of the Caterpillar

engines they use come from America, the engines that go into the DAFs come from the Continent, and there are some Cummins engines still. The cab used to be a British-made cab by the Motor Panels company, part of Mayflower, but they lost the contract for that to Renault, which meant that the UK value of the Leyland truck instead of being 80% became 54%—nothing to do with the Euro, just lost the order. So we are hanging on with that but our strength, if strength it be, is actually on vans, particularly the panel van—the Transit-type vehicle. The big success of the last few years has been the General Motors/Renault joint venture where in Luton products are made with the Vauxhall badge, the Opel badge, the Renault badge and the Nissan badge, and that is the reason why, in that category, we have 57% exports. In other categories virtually nothing, apart from about 37% exports of the rigid trucks, and mainly in small numbers.

Q410 Linda Perham: Returning to cars, you said at the beginning of your evidence and in your remarks that we import 81% of our cars and export 69%. Is there any leeway for import substitution that we could, perhaps, export more and import less? Or maybe there is a problem with the change in the sourcing of components in what is a British car?

Professor Rhys: That is a very good point because the new factories make products which are made in Britain, but in the preferences of the consumer they will simply be seen as Japanese cars made in Britain, or French cars made in Coventry. It is not like Ford was—that was sort of British, was it not? It had been made here since 1911, you knew it was not British but it was not American either—there was something about it. Unfortunately, we have not been able to transfer that little bit of goodwill, perhaps, to the new factories. So what they are, effectively, is to make imports into the UK, in terms of the brand. There is no particular psychological edge that these vehicles have. All you have got to hope for is that they will come up with products which are the ones that the consumer has been waiting for and the consumer disproportionately will go to that sort of product. As I said earlier, we were hoping that would have been the case through the 1990s but it has not happened. It is the British consumer perhaps. We love choice, the amount of choice in the market is astounding and you cannot make more than a fraction of that choice basically. That is the same in France, the same in Germany, the same in Italy. The old-fashioned domestic content of the market, by which I mean the Italian content in Italy, the German content in Germany, the French in France, is all falling as this Europeanism takes over and you regard that product made in Italy as just as good perhaps as the product made in France. It is Italy where the big unravelling has occurred because Italy, in a way, is a bit like Britain where the British motor industry ended up in British Leyland; all the others were still on the periphery around it. In Italy Fiat bought the lot, so if Fiat is not working the Italian industry is not. There are only a tiny handful of cars that are not made by Fiat. The result is that imports are growing at an incredible rate in Italy. The import content in Italy is itself heading towards 80% and this is the new Europe. It could well be that we are ahead of the game but the fact is by exporting so much to Europe we are not anything of the sort, we are just selling in other parts of the world market. Consequently, that is the lesson that the Italians will have to learn, and they have not been good at it because that is the problem with Fiat, the further north you go in Europe, the smaller the market share of Fiat. Essentially they are a South European company. The French are having to learn that lesson and the Germans are having to learn that lesson. It is possible that we will be able to sell a slightly higher proportion in the UK but I would not hold my breath for it. It seems that this is it, this is the new Europe.

Chairman: On that topical note, we will finish, Professor Rhys. Thank you very much, that has been very helpful. If we need to come back to you we know where you are. Thank you very much.

Witnesses: **Ms Sarah Chambers**, Director, Automotive Unit, **Mr Ashley Roberts**, Deputy Director, Automotive Unit **Mr Francis Evans**, Head, Automotive Unit Birmingham Office, and **Mr Philip Davies**, Analyst, Automotive Unit, Department of Trade and Industry, examined.

Q411 Chairman: Good afternoon, Ms Chambers. Perhaps you could introduce your team and we will get started.

Ms Chambers: Thank you, Chairman. I have Ashley Roberts on my right, who is Deputy Director of the Automotive Unit in DTI. Francis Evans, on my left, is Head of our Birmingham team, our regional team. Philip Davies, on my extreme right, is our Analyst.

Q412 Chairman: Thank you. I think you have been in the meeting for most of the afternoon so you have seen the ground we are covering. I think there is a sort of schizophrenia in Britain about the car industry, as there are in so many other industries, in the sense that people very often do not realise how well they are actually doing but, having said that, that is little cause for complacency. How confident are you that this can be sustained, this comparative success?

Ms Chambers: I think it is never possible to be totally confident because in this industry it is fiercely competitive. Our industry has to continuously improve itself if it is going to be able to retain the place it has got in the world market. I see no reason why it should not do so. It does need to continue to produce the right products, products that consumers want to buy. It needs to continue to be innovative in its manufacturing processes so that it produces those vehicles as efficiently as it possibly can and to the right quality. We need to continue to update the skills of the workforce that are making those cars or else we will not be making them as well as we should.

It is a constant battle to stay up with the big boys who are going to make it in the future. It is not easy but I see no reason why industry in the UK cannot go on succeeding and continuing to export in the way that it has been doing. I think the last point that Garel Rhys made was very pertinent. In some ways we are ahead of the game because we have been playing on the global stage for a long time, we are not dependent on a captive domestic consumer. It would be very nice to have some captive domestic consumers, which we do not, but because we do not we have got rather good at selling to a very discerning global market. I think we have certain strengths that put us ahead of some of our competitors, but it is not going to be easy to keep that.

Q413 Mr Djanogly: It has been suggested to us that the UK can be overenthusiastic when it is putting in place European regulations and tends to goldplate them. Is this something that you have been addressing?
Ms Chambers: It certainly is. It is not the first time that we have heard that point made. The manufacturers continuously tell us that we must be very careful not to goldplate our regulations or to bring them in in an unseemly rush and it is something that we have been paying quite a lot of attention to in recent years. There are a number of ways we have been doing that. I think the last time I was before this Committee we were discussing the End of Life Vehicles Directive and that is a case in point where I know the manufacturers were very worried that we were going to implement that Directive in a way which was faster than every other Member State and perhaps more intensively than every other Member State and there was a big concern about that. We made sure to lay down some principles when we were considering implementation, principles of a level playing field across Europe and not harming the competitiveness of the industry in the UK. We stuck very, very firmly to those principles even when it meant that we knew we were going to be late in implementation. We decided it was much more important to get it right, to make sure that the competitiveness of our industry was not damaged. That is what we have done and I think the industry have now appreciated the way that we have implemented it is in line with the rest of Europe and has taken full account of their concerns. That is just an example of what we have done. We are trying to repeat that across the board. We are also trying, and I think we are the first in Europe to do this, to have a look at the impact of the regulatory framework on the automotive industry across the board. Toyota, in their evidence to you, called it the wall; they can deal with the individual bricks but climbing over the wall of all these different bits of regulation is very, very hard, and it is particularly hard when the people who are making the individual regulations do not necessarily talk to each other and realise that there is a cross-impact of different regulations on each other. We in the UK have set up what we call the VIPER group, the Vehicle Industry Policy and European Regulation group—it has got a nice name—which is to do precisely that, to look at the whole wall from a top view down to see what impact this is having on the competitiveness of the industry as well as on the objectives that the regulations are trying to do, trying to make sure that the regulations are going to achieve their objectives without having unforeseen consequences and without damaging our industry.

Q414 Mr Djanogly: Has that just started?
Ms Chambers: No, it has been going for over a year now. It started early last year.

Q415 Mr Djanogly: Have they come out with any conclusions from that?
Ms Chambers: It is not really the sort of group that comes out with that. It is not like the Automotive Innovation Growth Team which had a very specific remit to look into the industry and come up with some conclusions about what needed to be done, this is much more of an ongoing process where we are looking at regulations as they come up, preferably looking at regulations before they come up, anticipating what might be the next thing that comes over the hill either from Brussels or elsewhere in Whitehall or whatever. It is ongoing. It is about looking at the effect of everything that is going on. It has spawned all sorts of interesting discussions on individual regulatory issues as well as looking at the impact of one regulation on another. It is not great media astounding stuff but actually the industry does appreciate it quite well.

Q416 Chairman: It seems that our End of Life Vehicle investigation was not all in vain then.
Ms Chambers: Of course not.

Q417 Linda Perham: I mentioned that End of Life Vehicle Directive to one of my staff who thought that we were talking about hearses.
Ms Chambers: We will look into that one.

Q418 Linda Perham: You mentioned competitiveness and I come back to the question my colleague was asking about regulations. When we did our previous inquiry we also went to the plants that had problems, and indeed some of them were closed, Luton, Dagenham and Longbridge.
Ms Chambers: Longbridge is not closed.
Linda Perham: I said some of them were threatened with closure or had problems anyway.
Richard Burden: You took a couple of years off my life then.

Q419 Linda Perham: That is why I said some were threatened with closure. The word that was always mentioned by the workforce and the union representatives was flexibility of the labour market which we have in the UK and that was seen as a problem, it is much easier to close plants, or threaten to close plants, in this country, and yet employers in business are always saying we are over-regulated. Where do you see the balance being for the UK automotive industry?

Ms Chambers: Flexibility does have two sides. I think if we did not have a relatively flexible regulatory framework here compared with some of the other Western European Member States we would encourage less investment than we do now because it is very important for companies to know that they can take on extra workers without necessarily being saddled with them keeping forever. The motor industry, perhaps more than some others, is subject to big fluctuations. Maybe the obvious company at the moment is Peugeot which took on this fourth shift about 18 months ago because they had to meet some extra demand for its very, very successful 206 and the new variants of that. It has recently announced that that fourth shift is no longer necessary and they will have to let some of those workers go. If two years ago we had had a very rigid labour market, I do not think it would have ever taken on that fourth shift, so we would have lost 18 months' worth of extra production, it would have gone somewhere else and the UK as a whole would have lost out. The balance of the argument is that flexibility is a good thing but it needs to be kept within bounds. There has to be a balance. There has to be a certain amount of certainty about where you are.

Q420 Sir Robert Smith: Are UK based vehicle producers being put at a disadvantage by uncertainty over currency exchange rates?
Ms Chambers: I think the answer you got to that question from Garel Rhys does not fully reflect what I am hearing from manufacturers. What I am hearing from them on the whole is that they are disadvantaged by being outside the Eurozone. They do not all say so very loudly and they say so to different degrees depending on who you are talking to. I think it is more than just whinging. I think the stability argument is a very important one. Most of these companies are planning over very long timescales and being a very competitive industry it is a very small profit margin that most of them are working on, so fluctuations in currency are deeply significant to them. The Euro-Sterling exchange rate is not the only one that matters, of course, and that is something that we always need to bear in mind. There are other reasons why being in or out of the Eurozone might help them or not, but undoubtedly there is an argument about the instability of currencies being a factor which would go against them.

Q421 Sir Robert Smith: It is one of the sectors where they see more of an upside of stability coming from fixing our exchange with the Euro.
Ms Chambers: That is what most of them tell me. I think different manufacturers may have different views, there is not one absolutely clear view that you get from the industry. That is what most of them are telling me.

Q422 Sir Robert Smith: Given that there is still not any immediate prospect of directly joining the Euro, is the Government doing anything else to overcome that perception of disadvantage?
Ms Chambers: I think most of what we are doing is about making sure that the industry are helping themselves in areas where they have got some control and where we can help them, which is about improving productivity, improving skills and so on. There are a small number of what we hope are going to be quite high impact initiatives that we are taking forward with the industry to try to make sure that our industry is competitive, maybe even more competitive than their French and German counterparts, in order to overcome the disadvantage of being outside the Eurozone. I think those initiatives are good ones.

Q423 Mr Hoyle: Obviously we have heard about differing levels of productivity between different plants in the UK and I wonder what role or what route the Government can take to assist to ensure that we get the best levels of production coming out of all plants. Is there anything that you have in mind to ensure that production is equal across plants?
Ms Chambers: I am not sure that it is our objective to get equal production across plants.

Q424 Mr Hoyle: Not so much equal but to improve the poorer plants. If we take Longbridge, most people would say that the reason for Longbridge is it is outdated, it is the wrong design and the wrong shape and that may be somewhere where the Government can step in and say "Let us look at that and give them the money to redo it", I do not know.
Ms Chambers: The productivity measures that most people quote when they say that some of our factories are very much more efficient than others, the statistics are very crude ones and tend to be based on cars made per person. I do not think they truly reflect the real measure of productivity, which is value added per person, and they certainly do not measure anything to do with total factor productivity which is really the measure you want to get at if you are trying to look at who is producing most efficiently. Bearing in mind everything that goes in, if we were to try to get those statistics we would get a much more complex picture. Nevertheless, it is undoubtedly true that there are some plants in the UK which are better, more efficient, more productive than others and we are trying to do what we can in partnership with the industry to try to spread best practice. We have a National Supply Chain Groups programme which is particularly trying to filter things out downwards to the supply chain where the differences are most pronounced. We have the Automotive Academy where we are trying to spread the skills from one set of people to another. The SMMT Industry Forum, which we have supported over the years, is also designed to spread the benefits of some of the best companies to all the others. Yes, there are a number of initiatives which industry has led with our support over the years and which we are continuing.

Q425 Mr Hoyle: Do you think that there is some disadvantage to being an indigenous car maker as opposed to somebody from overseas where it seems to be, "Come here, what do you want? What can we help you with? Here is the chequebook, here is the land, here is whatever", whereas if you are an indigenous car company there is nobody to turn to in the same way?

Ms Chambers: I do not think that in itself is true. Whether you are indigenous or foreign-owned, the assistance available is exactly the same. You can get Regional Selective Assistance if you are in the right region and you cannot if you are not in the right region. If you are in a region that does not quality for Regional Selective Assistance you cannot get it and that has got nothing to do with whether you happen to be foreign-owned or not. I do not think that is true. There is some truth in the proposition that it is easier to become very productive on a greenfield site than it is in a very old factory, but even there the evidence is mixed because if you see what Ford PAG have managed to do at Halewood, they have managed to turn around that rather old, inefficient site with all sorts of problems into one which is now the best performing Ford factory in the world, which is quite an extraordinary achievement. No, I do not think it has got anything to do with being indigenous or not. Being a greenfield site can help because you can make sure that you have got everything aligned but that does not mean there is not room to really pick up some of the older factories in our country, and I think some of our companies are trying very hard to do just that.

Q426 Mr Hoyle: Can I move on to another point about procurement. What is it about the UK that somehow we never seem to be able to buy cars that are built here and yet if you go to France, Germany or Italy you will never see an ambulance, a police car or anything else that was not built in their own country? Why do you feel that we have not got the same procurement policies as they use?

Ms Chambers: I do not think it is so much about procurement policies as about cultures. I think we have a culture in the UK, a consumer culture, which is based, and has been based for a long time, on value for money and not on location of manufacture, whereas in France and Germany there still is a much stronger culture of buying from the country that you are in. I do not think that is just about public procurement, it is about private procurement as well. I do not think they need to have a public procurement policy in France and Germany which says "thou shalt buy French" or "thou shalt buy German", they would not be allowed to under the European State Aid rules, just as we are not allowed to, but the point is in France and Germany they do not need it because it is a natural thing that they will look to their own companies first and all other things being equal they will automatically go for their own country's products.

Q427 Mr Hoyle: Maybe it reflects government policy, that people have pride because the Government has pride. I will give you another example and maybe you can answer this for me. We have just heard a statement made that because of accidents on motorways we are going to have this highway patrol that will come and clear the vehicles away and get the motorways moving very quickly. What vehicle do you think they would drive? A four wheel drive, you would probably say Land Rover, even Honda does a four wheel drive but they have bought Mitsubishi, which is not British, not built in Europe so it does not even come under EU policy. The statement made was we do not believe this is the right vehicle for the job because they are not the best for motorway use. This is absurd. Once again, we will see this huge number of vehicles on the motorway carrying the Japanese badge with no jobs for the UK. Do you not feel worried? Do you not feel ashamed?

Ms Chambers: I cannot answer for any individual procurement decision. In terms of Government policy, we are—

Q428 Mr Hoyle: What advice would the DTI be giving to the Highways Agency? I think that is the key, is it not?

Ms Chambers: The advice that we would have to give to the Highways Agency is that we do have to abide by EU State Aid rules.

Q429 Mr Hoyle: This is a Japanese-built vehicle; do not keep hiding behind Europe. It is a Japanese-built vehicle that has been supplied to the UK being bought with taxpayers' money to provide a service. Forget the EU, what would your advice be to the Highways Agency?

Ms Chambers: The policy of both the Government and the EU is that value for money has to be the prime consideration for any public procurement. If that vehicle turns out not to have been best value for money, is not the right product for the job, then something has gone wrong. As I say, I do not know anything about that particular contract so I do not think I can answer for it.

Q430 Mr Hoyle: Okay, I will give you another one then: police vehicles. We have probably the finest van vehicles in Southampton, we produce the transit van that has been the backbone of UK industry for generations, and suddenly we see them being used by the police. My understanding is that they do not win the tender upfront but what they say is it will be an after-sales buy-back arrangement that has persuaded the police to buy. So there is a bit of jiggery-pokery to get around the rules in order to ensure that they use Mercedes, is there not?

Ms Chambers: I have no knowledge of that contract either.

Q431 Mr Hoyle: Do you think that when it is taxpayers' money where vehicles are being bought that the DTI ought to be sending out a circular, we ought to be looking at contracts? It is no use saying "I do not really know", I think we ought to be proactive backing up British industry and at least supporting jobs in the UK, especially when it is taxpayers' money that is being used.

Ms Chambers: Absolutely.

Q432 Mr Hoyle: We start with off with the ministers as the first resort because they do not all use British vehicles either.

Ms Chambers: Our Secretary of State is extremely interested in this issue of public procurement and how we should become more intelligent in our public procurement without, of course, going outside the rules. There are all sorts of things that intelligent procurement can look at, including innovation in our own industry, the prospect of competitors still being around in a few years' time so that they will have choice, not just now but in three, five, ten years' time. There are all sorts of things that can be looked at. I think the Chancellor announced a review of public procurement policy across Europe last December and also that is going to be looking at what is going on in other European countries so that our companies can get smarter on how to get into their markets as well as thinking about how we can get smarter at using our own domestic public procurement contracts. Yes, it is something we are interested in. I understand exactly what you are getting at and I know that it is something that is of major importance to our companies.

Q433 Mr Hoyle: Will you start by looking at the contracts that have been awarded as DTI to make sure that there is fair play and give advice to support British companies?

Ms Chambers: To look at every single contract that has been awarded in the public sector would require a whole new Government department.

Q434 Mr Hoyle: If we take the army vehicle contract—I will leave it at this one—we have heard that Leyland are supplying the army vehicles and there is not one British truck manufacturer bidding, they have been excluded. Does that not concern you?

Ms Chambers: It is something that we have concerns about and we do get involved but it is not the only consideration.

Mr Hoyle: The EU rules do not apply to army vehicles.

Chairman: In terms of the Highways Agency, if we were going to have Chief Constables working for it, collecting the vehicles that have broken down, all vehicles would be Range Rovers.

Mr Hoyle: Mercedes actually.

Q435 Chairman: It does seem that some elements of public procurement are as much to do with the whims of some of the senior officials as it is anything else. ACPO and people like that perhaps should be taken round the best of British car manufacturing plants and shown some of our quality vehicles. Perhaps that is something that the ministry should do.

Ms Chambers: As I say, we are looking at public procurement afresh and we are looking to see what we can do to make sure that we do get more intelligent public procurement which does take account of all of these factors.

Chairman: It does seem to have a kind of mind changing requirement which is not that far away from lobotomies or steam hammers. That seems to be the impression that a lot of us have. Quality is sometimes in the eye of the beholder, especially when you do not have to pay for it.

Q436 Sir Robert Smith: Can EU State Aid Rules be amended to make sure that specifications do not in any way rule out British suppliers?

Ms Chambers: Indeed, that is one of the things that can be done. One needs to be careful not to skew specifications too much.

Chairman: The Poitiers Customs Department comes to mind.

Q437 Richard Burden: In their evidence to us, the SMMT told us that investment in R&D is "worryingly low". You have heard what Garel Rhys had to say about R&D. Do you think investment is too low? What do you think Government should be doing to remedy that?

Ms Chambers: Yes, we are worried about R&D in the UK being lower than we would like it to be. We are worried that of all the automotive R&D done in this country, some 70% is done by Ford. It is great that Ford are investing that much in R&D in this country but it is very worrying that the rest combined are only making up 30%. This is something that we are actively addressing because we would like to see a far larger proportion of R&D that is happening in Europe and, indeed, in the world happening in the UK. If you do not mind a double answer, Chairman, could I just ask Ashley Roberts to elaborate on what it is that we are doing to try to encourage more R&D.

Q438 Chairman: We do not mind double answers, we just do not like duplication.

Mr Roberts: I think it is fair comment that our under-performance in innovation and R&D has led to a productivity gap, so we really need to address that. We have been attempting over several years now to start to tackle this issue through assembling a very powerful network across the industry to look at some of the issues. As a knowledge transfer network, the Foresight Vehicle programme was really trying to address the issues about innovation, how you can look at technology, road mapping where we want to be in the future and how we can get from where we are to where we want to be through this process and looking at critical technologies on that path where we might need to intervene. The programme itself has spent some money on real collaborative research which is taking things forward. It is also about assembling groups of people to make them more accustomed to working with one another. Although it is too early for a full evaluation because of the lead times, we are seeing that the intervention through Foresight Vehicle has led to greater investment in R&D by the participating companies, it has led to much more of a collaborative approach by departments and, indeed, knowledge transfer from the science base where we are very richly endowed in that upstream knowledge.

Q439 Richard Burden: Can you give us some examples of where it has led to that kind of improvement?

Mr Roberts: There are a number of thematic areas we have been particularly addressing. Power train is one in terms of conventional technology and in terms of alternative power train, design and manufacturing, so not just product development but process improvement as well, materials and structures and also the electronics content of the car which is becoming more important, as we have heard, 35% of the value of some cars. We are seeing across all those areas collaborations taking place and people starting to think about commercialising those technologies. It is a slow process and it is something that we have had to promote for a long time but we are seeing some companies who have come first to market with particular technologies perhaps where there has been some Government support in the past, going back several years, ten years perhaps, where we have been told anecdotally that they might have pulled out of that particular technology area were it not for just a modicum of support at a particular time. It does seem that it is not about quantities, it is about small amounts of funding, sharing the risk and getting a very robust road mapping process in place. Where we are today is that we have fully committed our funds to Foresight Vehicle but we are trying to raise this in order of magnitude through the new Technology Strategy and the Technology Fund which is looking to create even more critical mass in these technologies so that we can really attempt to solve this problem of the commercialisation of this knowledge and getting the supply chains involved in that process is key. I think a point that did not really emerge earlier today was the fact that a lot of the intellectual property in these new products and processes are actually owned by the supply chain and this is where we can start to make some real inroads in terms of cars in the future, making sure that we do get some niche activities in some of these areas.

Q440 Richard Burden: It would be useful if you could send something about some case studies where Government intervention has actually made a difference. I just wonder if hypothetically I was, say, an independent engine builder and I was looking to try to secure a particular contract overseas to develop a new kind of product or get an existing product up to EU regulations on emissions and so on, are you confident that as a fairly small company if I go, say, to my local Regional Development Agency or Business Link and say "Help, I need some backing to do this" I would actually get that or would I just be given a load of forms to fill in?

Mr Roberts: It is a big problem because the process to actually break into that market is very, very difficult. What we see, not just us but a lot of the agencies and a lot of the companies as well, is that a lot of people come up with their designs, "I have invented the perpetual motion machine" and things like this, which we receive an awful lot of, and we have got a number of people who have got particular products on paper which they claim perform a certain level of emissions performance or efficiency, and one of the big things we have been able to do to try to filter out a lot of the claims from the reality through the networking is to put the small people in touch with the larger companies here through the networking process. That is now being run by the SMMT who look after Foresight Vehicle. It is very important that there is an intelligent customer and that the supplier of the technology is actually aware of what the customer wants. It is all very well producing something but if the market does not want it, the customer does not want it, or there is one that works differently or the regulations are pushing it a certain way, there is a certain futility in that process. Again, I think a lot of trying to sort out the good ideas and taking those good ideas forward is through making connections with the customer, with the market, and that is the added value that we think can be brought through the process we have done and, of course, there is the infrastructure of the Small Business Service, Business Links, who can help people go through the process of applying for funding and things like that. It is a difficult problem and there are an awful lot of false claims. There needs to be a process to eliminate those, I think.

Q441 Richard Burden: As well as processes being able to differentiate the difference between claims and reality for firms applying for assistance, is that process of audit going on in terms of things like Business Link to see whether the claim of support is actually being met by the reality?

Mr Roberts: I cannot comment on the individual applications that have been made to Business Links for some of the small grants but certainly—

Q442 Richard Burden: I am asking how far that process is being reviewed, about whether the support and advice that is given is as good as it should be.

Mr Roberts: Wherever we are giving out money and making these connections there needs to be a proper evaluation process in place and I would expect that all the schemes would be appropriately evaluated. I cannot speak for where we are at in that process.

Q443 Richard Burden: Could I take you on to the issue of skills shortages. That is obviously a problem throughout the industry and a number of witnesses have highlighted skills shortages as being an issue. Could you say what steps are being taken to address that?

Mr Roberts: Just as much as innovation performance is contributing to a productivity gap, there is a skills gap too which is equally part of that issue. What we have tried to do is to look at the skills, the technology and the best practice, and we have tried to converge improvements in these areas to make a difference. Skills is an area where the AIGT, the Automotive Innovation and Growth Team, highlighted the problem and a number of other reports have highlighted the problem. What we are trying to do through the Automotive Academy is to set up an infrastructure which will actually put the employer at the heart of the skills agenda and then make the connection between individual skills and business improvement. It is through a process of upskilling and then that upskilling will lead to productivity improvements in companies. We are setting up an infrastructure which is based on validated materials, course providers and assessors, a national approach to training that the industry is driving. We are half way through that process now. We have invested a sizeable sum of money, one million pounds to date, in setting up the Academy infrastructure. It is now being launched as a legal entity under the auspices of the SMMT. It has an industry-led board, the Chairman of Jaguar is now in charge of that board and we are in the process of appointing a chief executive to the company. Then we will be investing a further sum of money, about £12 million, to ensure that this process is sustainable, that it works, that we are able to simplify and rationalise the availability of training, make sure that training meets the requirements of industry and, by having industry running the process, make sure that industry takes part and that we are not seeing competing offerings coming from different people but making sure there is a validation process so that there are accredited materials and providers that are delivering through the Academy and then having a regional infrastructure around the Academy to look at the skills gaps in particular regions and address those through training and support. It is very important that this initiative is a success because a lot of other sectors are looking at what is going on. We have the support of the Learning and Skills Council, we have the support of the Sector Skills Council in SEMTA who are looking at this. This is a flagship and it needs to be a success. Everyone is backing it at the moment. We have to make sure that the number of people who go through the Academy processes grows. There is a business plan in place which is looking to ensure sustainability. We are supporting that, we are on the board, and we are running a project and working very closely with SMMT and the Academy to address that.

Q444 Chairman: This is fine as far as manufacturing is concerned and improving the skills content there, but for a lot of us the maintenance of our vehicles is just as important and when we spoke to people responsible for the maintenance end of the industry they said—this is not a criticism, it is really more a query as to what you envisage—once the Automotive Academy is up and running and you are getting the skills improvements at the assembly and manufacturing end of the business, that you would try and improve the standards that prevail within the maintenance and general workshop standards as well.

Ms Chambers: I think I can answer that. It is not one after the other, we are doing both at the same time, if you like. There are two Sectors Skills Councils in the automotive industry. It is such an important industry that we have actually got two of them. One of them is SEMTA—which covers manufacturing more broadly and includes the automotive industry, and the Automotive Academy are going to be working with SEMTA—and the retail end, which includes the maintenance people you are talking about, is covered by a completely different Sector Skills Council, which is Automotive Skills Limited which Matthew Carrington was talking about earlier. That is already up and running and beginning to look at how to seriously improve standards across the sector, not just the technicians, although technicians are terribly important, but also the customer facing people at the retail end of the business which in the past has not been handled as effectively as it might have been, and the managers within the dealerships who have to manage all the parts of the business. There is already some good material that has been developed on management development programmes in the retail sector. We are not waiting for the Automotive Academy to be up and running and then transferring it to the retail sector, we are doing both at once. Obviously there will be some links between them because some of the skills that we are talking about are in common or transferable, but not all of them, there are some skills that are different which is why we had to set up a separate one for the retail sector who are more customer facing people.

Chairman: Perhaps when you have done the business on the car sales people you can pass on the secrets to politicians because we seem to have the same level of public esteem.

Q445 Linda Perham: Have you made any assessment of the likely impact on the UK vehicle industry concerning the expansion of the EU to the East?

Ms Chambers: The impact of the accession of the ten new Member States has already largely been anticipated by the automotive industry, as Garel Rhys was talking about earlier. I do not think the impact of the accession last weekend is going to be particularly revolutionary, I think we have already seen quite a lot of the impact upon us. We have already been enjoying the extended market, this market of 450 million customers, increasingly prosperous customers, which is a great market to be a domestic market for our customers. We have already been exploiting that for some years. We have also been challenged by the competition in terms of manufacturing locations and we have seen factories already being built in Poland and the Czech Republic and so on. We know that our manufacturing plants have to compete with them, they have already had to do so. This is not new because it has been coming. Whether the impact overall is positive or negative is difficult to say, it is a fact of life, it is part of the general impact of globalisation. We are working and living in a global marketplace, not a domestic marketplace. I think the UK, more than most countries, is well prepared for it because it is the way that we have been operating our industry and our markets for some time. I think on balance it may well be a good thing but there are certainly a lot of challenges in it.

Q446 Linda Perham: So good opportunities for exports?

Ms Chambers: Yes, good opportunities for exports and to become even better as we move further East and the Russian market, which is a very big market, becomes more and more open to us. It is a good market for exports. It may be a good market to get some of our components from, which can be a good thing for our vehicle assemblers and it can be a bad thing for our component manufacturers, it depends who you are as to whether this is good or bad. As a consumer it may well be a good thing because I think it is going to be another element which keeps the industry fiercely competitive and will keep prices down.

Q447 Linda Perham: I was going to move on to the components sector because you mentioned in your evidence in paragraph 2.6 about manufacturers pursuing cost cutting and hedging against currency fluctuations by sourcing abroad. Is there anything that can be done to help the UK components manufacturers or is this just a competitiveness issue which we have got to address along with everything else?

Ms Chambers: Yes, I think it is a competitiveness issue that has to be addressed in the way that we are doing through supply chain groups and all those sorts of things. The currency hedging and the cost down pressures work both ways, they are not all to the detriment of our components sector, it depends what sort of company you are. If you are the sort of company that is very dependent on the domestic market and if you are dependent on low value added products, you are going to find this time extremely challenging. If you are interested in exports, particularly if you are at the innovative end of the components sector, I think the opening up of the markets can be an advantage. If you look at our engines sector, that is what they have been doing. We export more engines than we import. That is one of the most important components of all.

Q448 Chairman: When we took evidence earlier this afternoon Professor Rhys was making the point that the way in which the car is going, the content is more about wires and the microprocessors and things like that than it is about widgets and the old bits and pieces that I do not wish to disparage but which seem to still occupy a disproportionate number of people in the West Midlands in the traditional car supply area. To what extent is the Government addressing this, as it were, medium-term structural change in the design of the motorcar? Nothing you have said so far takes account of that. You are saying it is tough, if you make old widgets you are going to get done over because the Hungarians, etc. will be doing that for 20 minutes and will put us out of business and they will come in with the next lot. There does seem to be a certain gap in the thinking there. If there is not, can you illuminate us as to how you propose to fill it?

Mr Evans: I will do my best to address that, Chairman. It was suggested to me once by a manufacturer of washers that there is no such thing as a low value-added product, there is only a low value-added process, in other words that any component, however humble, if it were made in the right way with the right skills and with the right cost base, in fact, could be made competitively.

Q449 Chairman: I think valve makers for radios would dispute that proposition.

Mr Evans: True. That is one possibility. If a product itself becomes obsolete then clearly no amount of Government intervention seeking to preserve that company or make it more efficient will, in fact, help and that would be bad advice. That is where the kind of technology road map that my colleague, Mr Roberts, referred to has become relevant where we may see a particular component will no longer be made. Where there is a future for it then it is surprising how even a steel pressing, firstly, shall we say, has a lot of technological content and, secondly, can benefit from a very close relationship at the design stage between the vehicle manufacturer and the supplier. It is in those areas where those very close relationships that Toyota, for example, most famously seeks to promote, and I think they spoke about this in their evidence to the Committee. If we can foster those interdependencies between UK-based vehicle makers and their suppliers, that is where local suppliers have an advantage. Clearly if, for example, labour content, because of the product, is going to be a very high proportion of the value then it would be very difficult for those companies to compete. If we take wiring harnesses, very few of those are now made in this country because it is a particularly difficult process to automate, so you see UK companies, such as Volex or TT, who have invested in the Far East and made products there but carry out their customer relationships and their R&D in this country. Outward investment, which may look like exporting jobs, may be the right strategy for a company in that type of component to survive. On the other hand, where the labour content can be much lower, particularly if there is good investment in mechanisation, then there is no reason why manufacturing in this country cannot be fully competitive with even the lower cost economies.

Q450 Chairman: I just worry a wee bit. We have seen the love affair with the PC and how we were assembling computers in the UK and it very quickly became clear it was little better than a screwdriver activity and you had to move up the supply chain. I just wonder if the same thing could happen to parts of the assembly of motorcars. If you are going to assemble cars in Britain you are going to assemble them, but the component element of it, which is highly technical, could well have to be almost exclusively imported on the basis that we do not have any capability in the UK. We are remarkably successful in the case of Ford in producing engines for the world, one in every four engines used by Ford is produced in the UK, but one does not see sophisticated electronic equipment of the kind that the next generation of motorcar might well require. Is there even green shoots, to use an old cliché, in the UK? If there is then, please, persuade us and tell us. It is important for us, for the record, to know where the next generation of sophisticated components for the car industry are going to come from and to what extent the United Kingdom is capable of playing a part in it or whether we are really chasing the game at the present moment and not worrying about what is there on the horizon. Sorry, that was a long-winded question.

Mr Roberts: There are two particular areas that we are looking at in terms of sustainable mobility. One is the clean powertrain, and we have mentioned low carbon technologies and possibly fuel cells as well, elements of low carbon technologies, and the other is telematics and technologies for sustainable mobility, congestion alleviation and all those activities, motorist assistance and crash prevention. In both of those areas we recognise that we need to grow the supply chains for the future. That might involve some companies transforming themselves into modern suppliers for the future. We are doing work through fora, such as the Low Carbon Vehicle Partnership, to look at how we can attract new companies into the sector. They could be electronics companies, they could be software companies, they could be people making fuel cells, fuel suppliers, going outside the traditional boundaries as well, it is not just exclusive automotive, it starts to involve the chemical industry, the fuel suppliers, certainly the ICT industries involved in this and making them aware of what the policy direction is in terms of reducing CO_2, in terms of emissions and in terms of mobility and starting to map out not just existing supply chains but a supply chain map for the future and looking at what best process there is to start to grow some new suppliers. One of the AIGT recommendations involved setting up centres of excellence in these two critical areas. What that is really trying to do is to look at the infrastructure, to actually try to look at integrating and structuring the UK using the expertise that we do have, which might be fragmented, and pulling that all together in this very critical area of future automotive supply and then looking to use that as a shop window for the rest of the world to encourage inward investment in this area where there are gaps or to encourage new home grown investments through transfer of technology from the knowledge base. Very much a key function of these centres of excellence is to bring about this change but to do it from a position of understanding the market. To a certain extent, part of what we are doing is about transforming the market because if people do not want to buy the cars, or if the cars are not available at the right price at the right time, then there is very little point investing in these technologies, so it is about a market transformation programme and making sure we have got the supply chains to deliver key products and processes into that future market.

Q451 Chairman: Have you any examples of success?

Mr Roberts: The Low Carbon Vehicle Partnership has something like 125–plus members. We have a very high-level board which has signed off the implementation plans for the centre of excellence. We have a number of Regional Development Agencies who are keen to get involved in the process. We have individual companies we are aware of who are involved in technology and turning that technology into product which could well end up under the bonnet of a future car. It is really about getting all of these people to work together. It is early days, of course, because there are no commercially available fuel cell cars. Trying to construct supply chains for some future market is very difficult, of course, because it is very difficult to get investors to buy into that. We are having some early results in that area in terms of getting people together and working in a common direction.

Q452 Sir Robert Smith: On the operation of the market, the Retail Motor Industry were concerned that manufacturers are still able to control the prices at which their cars retail. They are also concerned that in spite of changes to the Block Exemption, sales and servicing have not been properly separated and that competition is being undermined. Do you have any views on this?

Ms Chambers: In the DTI we are not responsible for monitoring or enforcing the new Block Exemption regulation so that really is a matter for the Office of Fair Trading, not for us. Obviously we keep an eye on the industry and we have an interest in it. I have not yet seen any evidence of wrongdoing in terms of people blatantly not abiding by the new Block Exemption regulation. From some of the things that I have heard alleged, some people think that there may be some things that are against the regulation. If they do have any such evidence I would strongly urge them to present that to OFT so that they can look into it. That is really all I can say about it.

Chairman: I think we have covered pretty well all the ground. I should say to you that five o'clock is one of these witching hours in the House of Commons when a lot of other meetings take place and we had intended finishing by five but your evidence and the others took rather longer. We are very grateful to you for the answers that you have given us, they have been very helpful. If we need to come back to you on points of detail or other matters then we will. Obviously once you see our report you will be replying to that again. If we are not happy with that we will have your political master or mistress in. On that happy note, can I thank you very much for your evidence.

Written evidence

APPENDIX 1

Memorandum by the Automotive Distribution Federation

The Automotive Distribution Federation is the trade association representing manufacturers, importers and independent wholesalers of vehicle components, accessories and consumables. Our members range from global component manufacturing companies supplying the vehicle assemblers with the parts used "on the line", through national and regional parts distributors, to local distributors (motor factors) servicing the needs of the garage trade across the UK. Our membership constitutes approximately 75% of the parts wholesaling outlets in the UK.

Our responses to the issues identified in the Committee's inquiry are given from the perspective of the automotive aftermarket; that is, the sector of the motor industry which provides service and support for vehicles once they have entered service.

As an important section of the supply chain of parts from the manufacturers to the final installer of the part, ADF members' activities are vital in providing the motorist/vehicle owner/consumer with a competitive alternative supply route for the items required in maintaining vehicles in a safe, efficient and economic manner.

1. Component Manufacture

The supply of components into the automotive aftermarket is a mature and overcrowded sector, with diminishing role for UK production. Over the past twelve months a number of manufacturers have announced closure of UK plants in favour of production in other countries. (GKN Driveline being the most recent, with an announcement this week). However, given that the majority of component producers are non-UK companies, it is unsurprising to find companies relocating production, not only on the basis of low production costs, but also on the basis of maintaining employment (and avoiding the costs of ceasing employment) in their "home" states.

Thus, from an aftermarket perspective, it is difficult to identify currently any real positive prospect for future growth in the UK production of vehicle components. The undermining of the UK's manufacturing base is of deep concern to us, both from the perspective of our own industry sector and also from the appreciation of the nation's future economic health. We would urge the Committee to support an expansion of UK manufacturing, particularly in this important economic sector.

2. Parts Supply to Vehicle Assemblers

One of the important provisions in the latest EU Block Exemption Regulations is the freedom for parts manufacturers to include their brand marks on parts supplied to a Vehicle Assembler (VA) as original equipment (OE). Linked to that is a prohibition on VAs' attempts to restrict supply of certain, usually highly complex, parts to the independent sector of the aftermarket; commonly referred to as "tied parts".

It is apparent that some component manufacturers are unwilling to jeopardise their "OE" contract by insisting upon the "branding" option and supplying all parts freely.

Thus, we have a potential for the independent aftermarket, particularly independent garages, to be prevented from identifying the original manufacturer of components removed from a vehicle and obtaining the components necessary to ensure the safe and efficient operation of vehicles. We feel that UK competition authorities should examine this point.

3. Vehicle Servicing and Customer Support

We have noted that, despite recent changes in EU Block Exemption Regulations, the ability of the independent sector of the garage trade to provide the service required by the motorist remains limited by the attitudes of the vehicle assemblers and their dealers.

In particular, the standards set by vehicle assemblers for the appointment of "Authorised Repairers" (that is, companies who can service new vehicles but do not sell them) are set at a level that prevents many independent garages from being appointed. Specific demands for dedicated areas within the garage for the individual vehicle marque, when that garage will be servicing a much wider range of marques, are seen as unrealistic. Likewise the demands for the use of equipment designed specifically for the vehicle marque and model rather than suitable generic tools and equipment, makes the exercise of applying for the "AR" status uneconomic. For instance, Citroen's recent announcement that more than half of their "AR" applicants had been rejected becomes more understandable when the cost of meeting those standards is revealed as being in excess of £30,000 and that Citroen demand a floor area of at least 200 square metres. Such demands favour ex-franchised dealers over independent garages.

Other aspects of access to technical data are still, despite the provisions of BER, being reported as causing difficulties for the independent repairers. However, to date we have received no documentary proof of infringements. But, as mentioned in respect of parts availability above, we feel that UK competition authorities should examine this point.

4. UK Skills Base

The independent automotive aftermarket, as in many other sectors of the motor industry, is suffering from a skills shortage. Right across our membership we receive reports of a lack of suitably qualified and motivated entrants to the automotive industry. The UK's educational system needs to identify and action the need for school-leavers to be equipped with basic numeracy and literacy skills and for them to understand the needs of the workplace. The ADF, along with many other industry bodies, has supported the establishment of the sectors' own Skills Council. However, the demands placed upon "Automotive Skills" could mean that more prominent areas of the automotive industry receive a greater attention than the, somewhat fragmented, independent sector. The ADF, along with other bodies representing this sector, is addressing this with the Skills Council but we feel that representatives of government should appreciate the need for skills development across the industry as a whole.

5. Regulation

The majority of ADF member companies, and likewise the companies who are their customers, are small local enterprises, often with single figure employee totals. The burden of compliance with regulation falls disproportionately upon those companies. Although we reflect this point whenever responding to consultation processes, our members cannot help but feel that claims of reducing "red tape" lack substance. The Small Business Service was established with a publicly stated objective to reduce the burdens upon small businesses. In reality their role appears to be more one of explaining the reasons for regulation and the methods of managing compliance, rather than actual reduction in regulation. Although this is a point that has a wider impact than just the UK automotive industry, we feel that the Committee has a responsibility to include this topic in its investigations.

The ADF appreciates this opportunity to alert the Committee to the concerns of companies operating in the independent automotive aftermarket.

4 March 2004

APPENDIX 2

Memorandum by the Confederation of British Metalforming

1. The Confederation of British Metalforming is the Trade Association representing three industry sectors:

Hot Forging.

Cold Forming and Fasteners.

Sheet and Pressed Metal.

2. All three sectors supply a significant proportion of their products to the automotive industry, eg Hot Forging produces crank shafts, suspension and transmission units, drive trains etc. Cold Forming and Fastening supplies the nuts, bolts, screws and Sheet and Pressed Metal supplies body panels and fabrications.

3. CBM Membership is over 200 companies, mainly SMEs and over 80% of total product is dedicated to automotive customers. The industry produces in excess of £2.9 billion worth of components and employs in excess of 35,000 people directly plus a significant number indirectly in the provision of non-core activities.

4. For the past 5 to 10 years, component suppliers to the motor industry have been subjected to a cost down regime applied by the car makers which has been typically a 5% to 10% price reduction year on year.

5. At the same time, component makers have been subjected to increased manufacturing costs eg:

Steel price increases of typically 50% since January 2003 plus new surcharges on steel tonnages.

Liability insurance premiums which have risen between 100% and 800% since January 2003.

Energy costs which have risen between 30% and 40% since mid 2003.

6. Compliance costs for component suppliers have risen sharply thanks to both EU and UK legislation and directives. The impact of the Climate Change Levy has markedly increased manufacturing costs but the rebate payable via NHI contributions has benefited the Service Sector at the expense of the Manufacturing Sector because of the latter's improved productivity levels. UK

compliance requirement is much higher than the rest of the world and among our EU partners. Much of the EU sees directives as aspirational and advisory. The UK both applies and gold plates directives. Regulatory Impact Assessments (RIAs) are undertaken in isolation with little thought given to the cumulative effect and cost of different and often conflicting legislation and directives. These statements are NOT anecdotal but result from experience gained while working in EU countries.

7. The purchasing policies applied by UK car makers has accelerated the rate of importation of components to the detriment of UK suppliers. As an example, the UK's Fastener manufacturing industry is now 15% of the size it was in 1986 while the international fastener distributor industry has flourished on the back of cheap Far East imports.

8. UK Metalforming sectors are suffering an increasing rate of attrition as they are unable to charge an economic price for the goods they make. They make world class products but the world is not prepared to pay the price they should charge to remain viable. UK companies are well managed, agile and innovative. The use of new technology such as FE and FV Computer Simulation as a design tool is widespread. Innovative and groundbreaking solutions to customer problems are the norm, not the exception, but UK companies cannot compete in world markets because of the costs they bear compared to competitors.

9. The rate at which manufacturing capacity, and therefore jobs is being transferred from the UK to India, China and other low wage, low regulation economies is increasing. In 2003 the UK lost 50,000 engineering jobs. In 2004 the figure is expected to be in excess of 120,000.

10. We now face the massive distortion of steel supplies caused by the China Effect. China's race to industrialise is causing a world wide shortage of steel and will increase prices significantly. It should be noted that this is an entirely new and unique situation. It should also be noted that the future price of steel will be much less important than its availability. The problem is simply that as European steel mills cannot obtain the raw materials necessary—iron ore, coke and scrap steel—to produce more steel, some have had to close. The shortage of the raw materials is caused by China's acquisition and retention of those materials. It follows that while the solution would be an increase in production of steel in Europe and the USA, the materials necessary for production are growing acutely scarce on the world markets. Some countries, eg India and Russia, have now placed embargoes on the export of scrap and other materials to protect their domestic steel making and metalforming industries. The UK and EU have made no such provisions which make our Metalforming and Automotive industries extremely vulnerable.

11. No-one knows how long the China Effect will distort the world steel and metalforming industries. What can be presumed is that as this is a world wide problem, there will be increases in the price of products containing steel, such as cars, white goods, IT equipment, medical items, whether they are imported or manufactured in the UK. Existing economic models showing a retail deflation in 2004 may well have to be revised and it is at present impossible to predict how many manufacturing and related jobs will be lost in the UK to the detriment of our economy and balance of payments.

12. Should the present situation continue, one can envisage car assembly relocating from the UK to areas where component supply and support can be clustered in a low wage, low regulation economy. The exponential rise in skill acquisition and product quality achieved by India and China makes this distinctly possible and economically sensible for the automotive industry.

APPENDIX 3

Memorandum by the Department of Trade and Industry

1. Introduction

The story of the modern UK automotive sector is a remarkable one—unique in Europe—of a sector which has embraced the challenges and opportunities of globalisation and not only survived, but thrived. At vehicle manufacturer and first tier component level the industry is based almost entirely on inward investment, in sharp contrast to France and Germany. Some inward investors such as Ford and GM have very long histories of manufacturing in the UK. Others such as Toyota, Nissan Honda and BMW are more recent arrivals but are now an integral part of the automotive industry in the UK.

Altogether eight companies manufacture cars in volume in the UK, together with seven truck and van manufacturers and many of the world's major component manufacturers. No other European country has anything like this range of automotive manufacturers. Some 68% of UK vehicle production is exported, whilst UK consumers are also global in their buying habits; over 80% of new cars are imported. Supply chains have also become much more multinational, so that UK content of cars made here has declined but the volume of parts exported has increased.

Globalisation brings risks as well as opportunities, and the industry in the UK has had to take its share of rationalisation and much-publicised closures, but overall the picture is one of remarkable resilience, based on continuous development and openness to world markets.

The automotive industry has two distinct parts; manufacture of vehicles and components, and sales, service and aftermarket services, each having their own characteristics. Manufacturing is subject to global demand, whilst the retail sector exists to satisfy UK consumer needs. However, there are strong strategic business links between these sectors, and these links will remain strong drivers for change.

This submission deals first with the manufacturing sector, starting with a global overview to set the scene in which the UK industry operates. Then it describes the UK retail sector, before discussing the various ways that Government is working with the industry to improve its competitiveness and ensure UK's continued presence as a significant force in the global automotive industry. Finally, the submission considers some of the challenges that will face the automotive industry in the future.

2. Automotive Manufacturing

2.1 *The Global Manufacturing Industry*

The automotive manufacturing industry is dominated by a few huge firms, which operate on a global basis. Six global groups account for over 80% of world car production. Consolidation in the commercial vehicle sector has gone even further, with five groups dominating the world market for trucks and buses. Large multi-national firms increasingly dominate the component sector, with a global presence to match that of the manufacturers. The major component manufacturers are seeking to establish a leading position in selected key technologies, reflecting a trend for suppliers to take on an increased responsibility for product design and development and the manufacture of sub-assemblies. Despite these trends some smaller independent companies continue to thrive by building strong competitive positions in niche markets.

The industry is technologically advanced, both in terms of manufacturing processes (often setting standards for other sectors) and in its products. It is characterised by economies of scale and low unit costs, despite the increasing complexity of its products. A key force driving technological change is environmental regulation. The industry has made major strides in the areas of emission control and safety, but will inevitably face pressures for further improvement.

The industry suffers from global over-capacity and with manufacturing best practice rapidly diffused around the world, the fight to build or retain market share is relentless and competition fierce. The intense pressure on suppliers is likely to increase yet further. Lean production, though essential, is not enough; companies are striving to sustain profitability by building desirable brands and through excellence in design, engineering and marketing.

2.2 *UK Automotive Manufacturing Overview*

Around 243,000[1] people are recorded as employed in the manufacture of vehicles and components in some 3,200 businesses. The sector contributes around £8.5 billion value added to the UK economy, and accounts for 1.1% of GDP, 6.2% of manufacturing value added and 9.5% of total UK export of goods. It should however be noted that this may understate the scope of the industry to some extent, as some components are manufactured by businesses classified to other industries. Alternative figures, which attempt to take this into account, are also in circulation.

The UK produces around 3% of global vehicle output (9% of European output) ranking 4th in Europe behind Germany, France and Spain, and 9th globally.

The West Midlands remains the heart of the UK automotive manufacturing industry, with about 40% of automotive added value generated in this region. There are other major concentrations in the North West, North East and Wales with a good spread of the remainder of the industry through most of the United Kingdom.

2.3 *UK Car Manufacturers*

The UK provides a manufacturing base for BMW (MINI, Rolls Royce), Ford (Jaguar, Land Rover and Aston Martin), Honda, MG Rover, Nissan, Peugeot, Toyota, and GM (Vauxhall) as well as a range of smaller producers serving specialist markets, such as sports and luxury cars and London taxis. After declining in recent years production is increasing at most of the major UK producers, driven by good export demand in Europe, US, and many other markets. Of the volume producers only MG Rover is UK owned. For the other companies, strategic decisions on future products and purchasing strategies are mostly taken offshore by the parent company.

[1] *Source* ONS: SIC codes 25.11, 31.61, 34.1, 34.2, 34.3.

UK CAR PRODUCTION 2003 BY MODEL AND LOCATION

Manufacturer	*Brand*	*Model*	*Units*	*Location*
BMW	MINI	MINI	174,191	Oxford
BMW	Rolls-Royce	Phantom	502	Goodwood
Caterham	Caterham	Super 7	435	Dartford
Ford	Aston Martin	All	1,476	Bloxham, Newport Pagnell, Gaydon
Ford	Jaguar	All	126,121	Halewood, Coventry, Castle Bromwich
Ford	Land Rover	All	147,545	Solihull
General Motors	Vauxhall/Opel	Vectra, Astra	122,857	Ellesmere Port
General Motors	Vauxhall/Opel	Frontera	9,576	Luton
General Motors	Vauxhall/Opel	VX220	1,204	Hethel
Honda	Honda	CRV, Civic	184,693	Swindon
LTI	LTI	TXI	2,346	Coventry
Metrocab	Metrocab	Metrocab	111	Tamworth
MG Rover	MG Rover	All except Citirover, SV	132,789	Longbridge
Morgan	Morgan	All	516	Malvern
Nissan	Nissan	Micra, Almera, Primera	331,924	Sunderland
Peugeot	Peugeot	206	207,237	Coventry
Proton	Lotus	All	1,731	Hethel
Toyota	Toyota	Avensis, Corolla	210,617	Burnaston
TVR	TVR	All	871	Blackpool
VW	Bentley	All	816	Crewe

2.4 *UK Commercial Vehicle Manufacturers*

The UK has six sites producing light and medium vans. IBC Vehicles in Luton built some 74,000 Vauxhall, Opel, Renault and Nissan badged vans (80% for export) in 2003, the Ford plant in Southampton around 55,000 Transit vans and LDV in Birmingham some 9,000 vehicles. In addition Vauxhall/Opel Astra car derived vans are produced at GM's Ellesmere Port plant, 206 vans are made at Peugeot's Ryton facility and MG Rover builds its Rover 25/MG ZR derived van at Longbridge.

The sole remaining UK volume truck builder is Leyland Trucks near Preston. The company is a wholly owned subsidiary of PACCAR Inc of the US—as is Foden (also built at Preston) and DAF in Holland. Within the last 10 years Volvo have closed their UK plant and the parent companies of others such as ERF (MAN) and Seddon Atkinson (Iveco) have moved production to mainland Europe. The Leyland assembly plant is one of Europe's largest and most advanced with 1,000 employees, building trucks under the DAF and Foden brands. Production was over 13,000 vehicles in 2003 in an expanded 6–44 tonne range. Leyland now builds 68% of all DAF badged vehicles. The PACCAR Group's UK market share in 2003 was around 22%—the market leader.

2.5 *UK Vehicle Production Data*

UK car production peaked in 1972 at just over 1.9 million cars, but a steady decline set in and within 10 years production had more than halved to under 900,000 units. However, growth has again returned with new investments at carmakers around the country.

In 2003, over 1.65 million cars and 189,000 commercial vehicles were produced in the UK. Of these over 66% of the cars and nearly 55% of the commercial vehicles were exported to a variety of markets. This is in stark contrast to the industry of 40 years ago, when most cars sold in UK were designed and built in the UK, mainly for the UK market. UK made vehicles are now exported to a wide variety of markets, with Europe the main destination, significant sales in North America, and specialist luxury marques sold around the globe.

UK's leading facility in terms of output is Nissan at Sunderland, with 332,000 cars produced in 2003. This is also Europe's most productive car plant[2], with Toyota (Burnaston) and Honda (Swindon) also in the European top 10 most productive car factories. 2002 saw the end of Ford car production at Dagenham (though the site is now their global diesel engine centre of excellence), whilst 2001 saw the arrival of the BMW Mini, now a major success around the world.

[2] *Source* WMRC—productivity defined as vehicles made per employee per year.

2.6 *Automotive Components*

Over the last decade the UK sector has been subject to significant acquisition and subsequent consolidation, mainly by US corporations, as individual companies expanded to meet the challenges of supplying the rapidly globalising automotive industry. At the same time vehicle manufacturers have substantially reduced the numbers of their primary suppliers (tier 1 suppliers) and put increasing responsibility for innovation, development and liability on them. Companies therefore need the resources and global reach to deliver and provide economies of scale.

The market is dominated by a small number of global players, with GKN, Johnson Matthey and Pilkington still UK owned and based here, with a large number of small to medium sized companies also active. Over 2,500 companies are active in the automotive sector, contributing over £4.7 billion added value and employing about 148,000 people.[3] The component sector exported £7.6 billion worth of goods in 2002, three quarters of this destined for Europe, and over £1 billion-worth to the Americas.

In recent years, the components sector has been under severe pressure. In part this is attributable to the need to be close to vehicle manufacturers, wherever they are located. But further turbulence has resulted as vehicle manufacturers have increasingly been purchasing components from European suppliers, and further afield, as a natural hedge against currency fluctuations. Typically, the UK sourced content of a new model has halved compared to the model it replaces. Moreover, suppliers continue to face the relentless quest by vehicle manufacturers for year-on-year reductions in prices of 3–5% on average, but up to 10% in some cases, against a backdrop of rising raw material costs.

The UK is an increasing force in engine production thanks to major recent investments. BMW's Hams Hall facility produces a significant proportion of the company's engines, all for export, whilst Ford will source 25% of their global engine supply from the UK. UK engine manufacturing output is rising, and represents substantial net exports. The growth in engine production for export is an example of the status of the automotive industry in the UK as an integral part of the global industry.

2.7 *Design Engineering*

The UK has a long-established, independent, design engineering sector whose service offerings exploit the full spectrum of capability from concept design through to limited-series vehicle production. The sector's assets include major testing facilities for vehicles, systems and sub-systems and it has a particular strength in powertrain development. It includes companies with origins and market focus in the mainstream automotive sector and those that have evolved from other sectors, such as motorsport. It has successfully competed both with overseas counterparts and the in-house capabilities of vehicle manufacturers themselves but is currently facing the additional challenge of low cost design services from for example Asia and Eastern Europe.

The UK design engineering sector is recognized internationally for its flexibility and responsiveness and for the innovative qualities of its engineers. The sector continues to evolve and the last five years have witnessed a succession of acquisitions, closures and re-emergences in response to the changing demands of its global market. The sector employs about 7,500 and has a turnover of around £0.65 billion, with an export proportion around 65%. Its more successful companies are those that have best responded to the market's demand for world-class expertise, integrated into appropriate packages and delivered locally to the customer.

The UK is also strongly influential in vehicle styling with many British designers and alumni from British institutions directly employed by vehicle manufacturers around the globe.

2.8 *Motorsport*

The UK remains the global leader in motorsport, with UK firms commanding around 80% of the global market. The UK motorsport industry directly employs nearly 40,000 people. Of particular note is the spread of capability from motorsport to mainstream automotive. Examples include Prodrive, which has moved from its roots in rallying to offer design engineering and development services. The company is able to secure a competitive advantage in these areas as a result of the motorsport culture of teamwork and on-time delivery. In the case of McLaren, the company's relationship with Mercedes Benz has led it to develop and build a road car (the Mercedes-McLaren SLR) drawing on motorsport technology and the UK's unique network of specialist suppliers. As brand values become ever more significant in securing competitive advantage, motorsport offers global manufacturers a unique platform to establish their reputation. The transformation of Subaru's position in the UK market, thanks to their success in rallying, is perhaps the best-known example.

[3] *Source* ONS: SIC codes 25.11, 31.61, 34.2, 34.3.

3. The UK Automotive Motor Trade Sector

3.1 *Introduction*

The "motor trade" encompasses new vehicle sales through franchised and other dealers, traders in used vehicles, vehicle maintenance, servicing and repair, and aftermarket sales of spare parts. Around 544,000 people are recorded as employed in the motor trades in some 65,000 businesses, contributing over £20 billion added value to the UK economy and accounting for 1.9% of GDP.[4]

The mood is upbeat for new vehicle sales in a strong market, with 2003 car sales at a new record level in excess of 2.5 million units. Vehicle manufacturers and retailers are price-cutting to maintain market shares, and this has undoubtedly helped drive sales to their current level. The used market is also strong, with residual values holding up well.

Profit margins on vehicle sales are however historically low: particularly noticeable with pre bonus margins (when discounting any special incentive payments from vehicle manufactures to retailers for say, reaching volume targets). This year new vehicles are attracting 1.6% pre bonus margin and 6.2% post bonus. For the used vehicle market, 2003 margins are around 7.5%. Despite price cutting, dealers' net profits (ROCE) are better this year compared to last, but are still only averaging around 2% currently (2002: 1.4%).

After-sales profits are also under pressure due to lengthening service intervals, price competition and rising labour costs.

3.2 *Main Developments*

Implementation of new Block Exemption Regulations (which allow vehicle manufacturers to operate their franchised network of car retailers without breaking competition rules) is presenting both threats and opportunities. Vehicle manufacturers are restructuring their retail networks, with many dealer contracts not being renewed. Manufacturers have raised standards of operation of their retailers, with retailers forced to invest heavily to meet these new standards in order to be issued new contracts by manufacturers. The cost of market entry is continuing to rise. Under the new regulations, some dealers are considering giving up new vehicle sales and becoming approved repairers only.

There is likely to be a rash of takeovers during 2004, with large franchised dealer groups acquiring smaller dealerships. For instance, Pendragon Plc has already announced its takeover of CD Bramall Plc. Should the takeover go ahead, Pendragon would be the largest retailer by far operating in the UK market, with about 250 dealerships, which represents about 4% of the total franchised dealerships in the UK. Recently, OFT published the findings of its market study into extended car warranties. It concluded there was insufficient consumer detriment to justify a full investigation and referral to the Competition Commission. However, the OFT did recommend that the industry rapidly improve the transparency of information available to consumers describing the contractual and other conditions of warranties and extended warranties. OFT will review the market situation again in 2004.

4. Government/Industry Co-operation

4.1 *AIGT*

The Automotive Innovation and Growth Team (AIGT) brought together industry, government and other stakeholders to assess the competitiveness of the industry and recommend actions to help it to face future challenges. In May 2002 the AIGT made a series of recommendations including the establishment of an Automotive Academy to foster improved business performance through skills enhancement; funding for supply chain groups extending across the UK;[5] the establishment of two centres of excellence in low-carbon and fuel cell technologies and in-transport telematics and technologies for sustainable mobility; the creation of the Low Carbon Vehicle Partnership; changes to the Foresight Vehicle programme and the establishment of a Retail Motor Strategy Group.

Ministers endorsed the AIGT's conclusions and Government has committed £45 million to fund the implementation of the three major initiatives. The Automotive Academy is being taken forward by a board headed by Joe Greenwell, Chairman and CEO of Jaguar and Land Rover. It will shortly be established as part of the SMMT and is undertaking a programme of development work in preparation for its full opening in October. The Supply Chain Groups programme was launched at the end of 2002 and has so far funded 10 programmes involving 94 companies. A panel of purchasing directors from vehicle manufacturers and Tier 1 suppliers appraises applications. The DTI's Automotive Unit is also working closely with industry representatives to develop the plans for the two technology centres. It is expected that both will be launched by the end of May 2004.

---

[4] *Source* ONS. SIC classes 50.1, 50.2, 50.3, 50.4.

[5] Supply Chain Groups bring firms involved in the production of a particular component together to improve their overall efficiency.

The AIGT recognised that the automotive industry is inevitably affected by a wide range of public policies. Sir Ian Gibson, chairman of the AIGT, placed particular emphasis on the importance of a continuing dialogue between the industry and all parts of government to ensure that policy takes account of the needs and concerns of business. As part of the reorganisation of the DTI Business Group its Automotive Unit has assigned relationship managers to the major firms in the industry with the role of providing a link between them and government.

4.2 *Foresight Vehicle*

Foresight Vehicle is a knowledge transfer network, recently taken over by SMMT, in which industry, academia and government come together to identify critical technologies for sustainable road transport. The network has produced a roadmap identifying the technologies that satisfy market requirements for mobility, safety, performance, cost and desirability as well as meeting social, economic and environmental goals. The supporting Foresight Vehicle LINK programme has provided funding for collaborative R&D in support of roadmap objectives. Over 100 individual projects have been started since 1997 with a total value in excess of £100 million. These cover the key technology themes of:

— Engine and powertrain.

— Hybrid, electric and alternatively fuelled vehicles.

— Advanced software, sensors, electronics and telematics.

— Advanced structures and materials.

— Design and manufacturing processes.

Industry has contributed around 50% of this figure with matching funds from DTI, EPSRC, DfT, Highways Agency, MoD, Home Office and DoH. DTI funding is now fully committed and the Foresight Vehicle network is making inputs to the department's new technology strategy with a view to securing future business support for collaborative R&D.

4.3 *Motorsport*

The UK's dominant position is under threat, notably from producers in Italy and the USA. There have been some recent contract losses, notably in the feeder formulae below Formula 1. Government and the industry together formed a Motorsport Panel to make recommendations on how to meet this challenge and in July 2003, £16 million was pledged by Government towards meeting the Panel's recommendations. These include the development of energy-efficient forms of motorsport, the creation of a Motorsport Academy and a range of business development activities. The retention of world-class motorsport events is also key and Government is working to secure the future of the British Formula 1 Grand Prix, the Motorcycle GP and the UK round of the World Rally Championship, the Wales Rally GB. These activities are taken forward through a Government Motorsport Unit, based in Northampton at the heart of "Motorsport Valley" led by the relevant Regional Development Agencies and including representation from DTI and DCMS.

4.4 *VIPER*

A significant development in 2003 (particularly valued by the automotive industry) was the establishment by the DTI's Automotive Unit of an inter-governmental forum for better policy and regulation making. This is the VIPER Group (Vehicle Industry Policy and European Regulation Group); an inter-Departmental (No 10, HMT, DEFRA, DfT, DTI) and automotive industry Group. VIPER delivers a joined up approach from "a one stop policy shop", through which the industry and Government add value to policy and legislative processes in the UK and the EU, and in the wider global context. It is an early warning mechanism for industry and other stakeholders on emerging policy and regulatory ideas, including those emanating from Brussels. (The VIPER model for Government-industry co-operation is likely to be replicated within DTI and other Departments for other industry sectors.)

4.5 *CarWise*

The Government, particularly DTI and OFT, have been working with both vehicle manufacturers and retailers to improve the deal that consumers get when servicing their car. Last year, retailers and vehicle manufacturers, together with the key trade associations, and DTI Ministers signed a Memorandum of Understanding, pledging to improve the deal for consumers. The Retail Motor Industry Federation is launching CarWise, which aims to improve the standards of servicing so as to provide the consumer with a better deal. It is envisaged that CarWise will shortly receive Stage 1 approval from OFT under its new code of industry practice scheme and it is hoped that OFT will award CarWise the final Stage 2 approval some time during 2004. CarWise has the support of DTI, consumer groups and car manufacturers. For the scheme to work properly by having as wide a membership as possible, car manufacturers will need to work closely with the Retail Motor Industry Federation in order to help incentivise the franchised retail networks to join CarWise. The Retail Motor Industry Federation is already working hard to recruit both independent and franchised garages into the CarWise scheme.

4.6 *Other Government Support*

Government assistance is available to the automotive industry in various forms. The principal financial scheme is Regional Selective Assistance, designed specifically to safeguard employment in assisted areas. Much of the UK automotive industry is located in such areas, and since April 1998 grant offers in excess of £100 million have been made to vehicle manufacturers and component suppliers around the country.

Devolution means that a major part of the responsibility for supporting industry now resides with the Regional Development Agencies and Devolved Administrations. The importance of the industry in particular parts of the country has led to the establishment of some major regionally based support programmes notably the Accelerate programmes in the West Midlands and Wales. DTI's Automotive Unit is working with regional bodies to ensure that regional and national initiatives complement each other so that companies know where to go for support. Examples include Advantage West Midlands' support for Premium Automotive Research and Development Programme, the funding and other support provided by RDAs and the Devolved Administrations for the Supply Chain Groups programme and the plan for the Automotive Academy to work closely with regional partners who will act as the local spokes for the Automotive Academy.

5. Challenges for the Future

5.1 *Manufacturing*

The principal future challenge is for the UK's automotive manufacturing industry to align its technology, product and business performance to deliver customer value at even lower cost. Vehicle manufacturers will continue to leverage suppliers' capability to improve their own products while they refocus on core competence. This provides opportunities to suppliers but also threats as vehicle manufacturers become even more sophisticated in their relentless pursuit of cost-down. Increasingly, lower value-added components are being sourced from lower cost economies and UK companies need to embrace a culture of lean manufacturing and sharing best practice to meet this challenge. The role of the Industry Forum to drive quality, cost and delivery standards further and deeper into the UK sector is as pressing as ever. However, process improvement, while necessary, is not sufficient and suppliers will have to invest in their people, knowledge and technology to offer greater added value to UK vehicle manufacturers.

5.2 *The Global Players*

Global vehicle demand is likely to remain relatively flat in the mature markets of North America and Western Europe over the rest of the decade. Most of the new growth is expected to occur in Eastern Europe, South America and Asia, the latter fuelled by China's dramatic expansion. Many observers of the automotive sector predict that SE Asian manufacturers will dramatically increase their global market share, including within Europe. The UK is in a unique position in that most of the global players manufacture in the UK; the challenge will be whether the UK can gain competitive advantage from this uniqueness, particularly when the key procurement decisions tend to be made on a European-wide basis at corporate centres that are rarely located in the UK.

5.3 *Regulation*

In global terms, the European Community is one of most highly regulated markets in which to manufacture, market, use and service motor vehicles. In particular, environmental protection and safety legislation are set to strongly influence the number and type of vehicles that will be manufactured, marketed and used in the Community. Ultimately, this will determine the choices open to consumers seeking to purchase and use cars. Further Voluntary Agreements and legislation directed at CO_2 savings and other exhaust emissions are imminent. The challenge for the UK (and the Community) will be to secure the environmental benefits whilst generating competitive advantage.

5.4 *Retail*

The past decade has seen a shift in added value from the manufacturing of vehicles to the retail end of the business chain. Other key drivers for change include the wide scale introduction of information technology, the application of lean business processes and the introduction of greater competitive forces in the European Community. As a result, the retail sector will continue to undergo dynamic change with the emergence of large retailer groups competing across Europe. Within Europe, the UK probably now has the most concentrated market in terms of domination by large companies, and this trend is likely to continue. The big challenge for the UK retail automotive sector is whether it can gain significant competitive advantage by the creation of strong UK-owned retail dealer groups that can grow in Europe and elsewhere. Over the next decade, the shift in value-added to the retail part of the business chain will also be a key commercial driver for the vehicle manufacturers, who will be striving to share in the commercial benefits of this shift.

5.5 *Skills*

A series of studies have identified skills shortages and gaps within the industry. The challenge is to put together effective training and education schemes that bring the skill levels within UK industry up to and beyond those of our competitors, enabling UK Industry to attract high quality recruits and compete more effectively in the global market. This requirement was captured in the Skills Strategy White Paper 21st Century Skills launched in July 2003. The Strategy aims to strengthen the UK's position as one of the world's leading economies by ensuring that employers have the skills to support the success of their business, and that employees have the necessary skills to be both employable and personally fulfilled. The Automotive Academy, through its administrative hub, with delivery spokes planned in Scotland, Wales and Northern Ireland and across the English regions, is working to deliver this change. It will establish a core curriculum of industrially-validated training programmes, providers and assessors supporting business improvement by working with stakeholders including the sector skills council (SEMTA), the qualification awarding bodies and the Learning and Skills Council whose providers will be responsible for the bulk of training delivery and assessment for the sector. The DTI Automotive Unit is also working with Automotive Skills Limited to help them develop the sector skills agreement for the retail sector.

5.6 *Innovation*

Innovation lies at the heart of improved productivity performance and the challenges described in the Government's Innovation Report, published on 17 December, are particularly applicable to the automotive industry in the UK. The Foresight Vehicle roadmap illustrates the societal, technological, environmental, economic, political and infrastructural drivers for change. Many of these pressures are pulling the industry in seemingly conflicting directions (such as requirements for recycling, pedestrian protection and reduced emissions) but new technology can help deliver solutions. The challenge for the UK is to ensure that we apply the best of our knowledge to these solutions as part of a strategy, which promotes both home grown and inward investment.

Key technology issues identified by the AIGT are concerned with the reduction of carbon emissions and sustainable mobility. The Centres of Excellence that we are establishing will play a key role in ensuring UK industry derives commercial benefits through process and product innovation in these areas. Cars of the future are the subject of a current enquiry by the House of Commons Transport Select Committee. The memorandum to that committee by the Department for Transport gives more information on technology challenges for the future, and how government is facilitating the development and introduction of promising new technologies, and ensuring the full involvement of the UK automotive and supplier industries.

6. Conclusions

The UK automotive industry has been through difficult times, and many challenges lie ahead if the UK is to maintain and grow its position in this highly competitive global market. However, the industry has many strengths and unique characteristics and DTI is committed to work with industry to build on these, so as to improve overall productivity and competitiveness through all means at our disposal. The UK should be able to gain competitive advantage in the global market by focusing on these strengths and unique characteristics.

APPENDIX 4

Memorandum by Ford Motor Company

1. Ford Motor Company ("FMC") welcomes the opportunity to submit written evidence to the House of Commons Trade and Industry Select Committee's inquiry into the British automotive industry.

Company Global Overview

2. FMC, headquartered in Dearborn, Michigan in the United States of America, is one of the world's largest vehicle manufacturers, with approximately 335,000 employees in 200 markets on six continents. Its automotive brands include Aston Martin Lagonda, Ford, Jaguar, Land Rover, Lincoln, Mazda, Mercury and Volvo. Combined global sales were 6,720,000 in 2003. Net income globally last year was $495 million, and turnover was $164.2 billion. FMC's automotive-related activities include Ford Credit, Quality Care and Hertz. FMC observed its 100th anniversary on 16 June 2003.

Ford Motor Company in Britain

3. FMC group companies in Britain employ around 37,000 people—approximately 45% of all Ford Motor Company employees in Europe. Close to 22,000 of these people are employees of Jaguar, Land Rover and Aston Martin.

4. Four Ford Motor Company brands build vehicles in the country—Ford "Blue Oval", Jaguar, Land Rover and Aston Martin Lagonda.

5. The Bridgend and Dagenham Engine Plants also build petrol and diesel engines respectively for Ford and Jaguar products. In addition, Mazda and Volvo have sales organisations in Britain, and Ford Financial Europe—Ford's financial services organisation—is headquartered in the country.

6. FMC group companies operate over 30 facilities in England, Wales and Scotland. A third of Ford's European spending, and over two-thirds of Jaguar and Land Rover's total spending, is in Britain. In total, Ford Motor Company spends around £8 billion in the UK each year. Jaguar and Land Rover is among the country's largest exporters to the United States market.

Ford "Blue Oval" in Britain

7. FMC's association with Britain began in 1903, the year of the company's founding in the United States, when two Ford Model A cars were shipped to the country. By 1908, a Ford sales company had been established, and the first Ford manufacturing plant in Britain was opened at Trafford Park, Manchester in 1911. The first Ford vehicle built in Britain was the Model T.

8. Ford Motor Company Limited ("Ford of Britain") has been the new car sales market leader in Britain for the past 27 consecutive years, and leader for 38 successive years in the medium commercial vehicle market with the Ford Transit. Britain is second only to the United States in terms of sales of Ford cars and commercial vehicles, and is the only major automotive market where Ford has both new car and commercial vehicle leadership. Ford of Britain accounts for around 25% of all Ford "Blue Oval" vehicle sales in Europe. In 2003, Ford had three cars in the Top Ten new car sales list, including the Ford Focus at No.1 for the fifth successive year. The Ford Focus was also the leading car model in the fleet sales sector, and Ford was the overall leader in the diesel sales market.

9. Ford of Britain employs approximately 13,300 people in Britain, and operates a dealer network with 582 Car and 218 Transit Specialist sales outlets. There are 621 Ford authorised vehicle repairers, plus 240 Transit authorised repairers.

Jaguar, Land Rover and Aston Martin in Britain

10. Jaguar has a long and distinguished manufacturing presence in Britain. The company was founded in 1922, began manufacturing vehicle bodies in 1928 and has produced complete vehicles in Britain since the mid-1930s. Based at its Coventry headquarters, Jaguar has undergone rapid growth in recent years, having increased the number of model ranges from two in 1998 to four in 2001—sales have increased from 50,000 in 1998 to 130,000 in 2002. The British market is extremely important to Jaguar accounting for 24% of total sales last year.

11. Land Rover has produced vehicles at its Solihull site in the West Midlands since 1948. Like Jaguar, Land Rover has grown significantly over the last decade, with sales trebling between 1992 and 2000, when more than 175,000 vehicles were sold. Land Rover's Defender had its 50th Anniversary in 1998 and approaching two million of these vehicles have been sold worldwide. The Range Rover is the most critically acclaimed Land Rover ever and the Freelander is Britain's best selling 4x4 vehicle. The British market is very important to Land Rover, accounting for 29% of total sales in 2003.

12. Created in 1914, Aston Martin is the world's most exclusive sports car company. Its new headquarters and manufacturing site at Gaydon, Warwickshire, was officially opened last September, and the company has just commenced production of the all-new DB9 Coupe. This coming autumn the DB9 Volante (convertible) will go into production. In mid-2005 production will commence of the AMV8 Vantage—the small Aston Martin model. This is in line with Aston Martin's objective to sell 5,000 cars per annum in more than 32 countries around the world.

Ford Motor Company Global Manufacturing Facilities

13. FMC has manufacturing facilities located in 25 countries on six continents. Manufacturing employment is about 80% of the approximately 335,000 people employed at Ford. The company produces passenger cars, commercial vehicles, engines, transmissions, castings and forgings, and metal stampings of all kinds at its 110 wholly owned, equity-owned and joint venture plants. The company has 20 engine plants globally.

14. FMC has 35 manufacturing operations in nine countries in Europe (including Turkey). Of its 20 global engine plants, six are located in Europe (including one in Turkey).

Ford of Britain Manufacturing Operations

15. Ford of Britain operates three manufacturing centres in Britain: the Ford Swaythling plant near Southampton which manufactures Ford Transit variants; the Dagenham Engine Plant in East London which is Ford's global centre of excellence for the engineering and manufacturing of diesel engines; and the Bridgend Engine Plant in South Wales which builds petrol engines.

16. Aside from manufacturing diesel engines for FMC, the Dagenham Engine Plant also provides engines for LDV commercial vehicles.

Jaguar, Land Rover and Aston Martin Manufacturing in Britain

17. The plant at Browns Lane, Coventry, is Jaguar's UK Headquarters and employs 2,500 people on final trim and assembly of the XJ and XK model ranges. 2,300 people are employed at Jaguar's Castle Bromwich plant, where XK and XJ body in white and S Type complete vehicle production takes place. Jaguar's X Type saloon is produced at Halewood on Merseyside where a further 2,500 people are employed.

18. Some 8,500 people are employed at Land Rover's Solihull plant where all four current models—Defender, Discovery, Range Rover and Freelander—are produced. In July 2003 it was announced that the next generation Freelander, expected in 2006, would be manufactured at Halewood.

19. A further 3,000 staff are employed at Jaguar/Land Rover's design and engineering centre at Gaydon, Warwickshire and 2,100 at Jaguar's Whitley Design Centre in Coventry.

20. Aston Martin employs 650 people at its new headquarters and manufacturing site at Gaydon and a further 350 at Newport Pagnell where Aston Martin's Works Service is also based.

21. Supply Industry—FMC's manufacturing activity in the UK has a direct economic benefit in terms of its impact upon the automotive supply industry. Jaguar and Land Rover spends £2 billion in purchasing goods and services from UK suppliers and makes a huge contribution to employment and the economy of the West Midlands in particular, although the positive impact stretches across the UK.

Current State of the Automotive Business

22. On 22 January 2004, FMC reported full-year 2003 global net income of $495 million, or 27 cents per share. This compares with a net loss of $980 million, or 55 cents per share, for full-year 2002. For the full year 2003, Ford's worldwide automotive sector earned a pre-tax profit of just $104 million in 2003.

23. However, Ford's "Blue Oval" European automotive operations reported a pre-tax loss of $1.1 billion for 2003, compared with a loss of $549 million a year ago—even though full-year revenue for Europe totalled $22.2 billion, up from $18.9 billion a year ago. The European market continues to be a very competitive marketplace for all players in the automotive industry.

24. Whilst Ford of Britain maintains its market leadership, the intense competition in the market means that profitability in Britain is limited. This situation is likely to continue into the foreseeable future. It is also anticipated that Ford "Blue Oval's" European full-year 2004 financial results will show a loss of between $100 and $200 million.

25. The Premier Automotive Group, of which Jaguar, Land Rover and Aston Martin form its British-based part, reported a pre-tax profit of $164 million for 2003, compared with a loss of $740 million last year. The improvement of $904 million primarily reflected cost reductions and improved mix, partially offset by unfavourable exchange rates. Revenue increased to $24.9 billion from $21.3 billion a year ago.

Investment Overview

26. In recent years FMC has made substantial new investments in the UK, and these investment actions are ongoing. Among the most significant recent investments are the following:

- Over £375 million has been invested on the Dagenham Estate, including over £312 million in diesel engine engineering and manufacturing;
- By the end of 2004, some £450 million will have been invested at Land Rover Solihull since FMC's acquisition of the Company in 2000;
- Over £265 million at Bridgend to build a new inline six-cylinder petrol engine for FMC's Premier Automotive Group brands;
- £300 million at Halewood for the production of Jaguar X-TYPE;
- £200 million at Castle Bromwich for the Jaguar S Type launched in 1999;
- £135 million has been invested in the new Jaguar XJ programme at Castle Bromwich and Browns Lane;
- £50 million at Southampton for the production of the latest version of the Ford Transit.

27. FMC's investment decisions are long-term commitments and take into account many factors including: market demand; existing manufacturing capacity; proximity to a competitive supply force; a productive, flexible and well-educated workforce; infrastructure support; grant assistance availability; exchange rate stability; GDP and economic growth of the country in question; past history of investment; plant productivity, etc.

Research and Development

28. Research and development forms an important part of FMC's activity in the UK and accounts for the overwhelming majority of automotive industry R&D in Britain, with around 10,000 people working at its three main technical centres in the country: the Ford of Britain technical centre at Dunton, Essex, and the Gaydon and Whitley complexes responsible for Jaguar, Land Rover and Aston Martin engineering development.

29. Ford of Britain's technical centre alone employs close to 5,000 people, and Ford of Britain's spending on R&D in Britain in 2002 was £484 million. Spending on R&D in the UK for Jaguar and Land Rover is annually around £456 million and is of critical importance in enabling the company to respond quickly to the market in terms of design, engineering and product development.

30. Other R&D is also conducted into diesel engine engineering at the Ford Dagenham Diesel Centre, and among the technical teams working in FMC manufacturing facilities.

FMC Spend in Britain

31. In 2002, FMC's total spend in Europe was $33 billion—of which around 34.5%, or $8 billion, was in Britain. That is roughly equivalent to twice the size of the Department of Trade and Industry's annual budget.

32. Ford "Blue Oval" spend in Britain in 2002 accounted for around 22% of its total European spend, while Jaguar and Land Rover's Sterling expense was over 60% for each company in 2002.

33. FMC is committed to a strong and healthy supply base in Britain—as evidenced by our continuing spend and by Jaguar's collaboration with the Warwick Manufacturing Group in the Midlands. This should be compared to the dramatic cut in Sterling spend by many of our competitors.

Issues Impacting on Ford Motor Company's Automotive Business in Britain

Over-regulation

34. In recent years there has been a significant increase in regulation on the automotive industry, much of it emanating from the European Union, and this is having a significant impact upon global competitiveness and increasing the cost of doing business in Europe. There are currently almost 100 EU Directives and Regulations relating to vehicles and these have been subject to more than 200 amendments.

35. The combined cost impact of current European laws on tailpipe emissions (Stage IV), recycling end of life vehicles, pedestrian protection and potential new laws on tailpipe emissions (Stage V), mobile air conditioning, chemicals products, and CO_2 is likely to exceed $5,000 per vehicle. Clearly, consumers are not prepared to pay for these cost increases. FMC believes that, too often, new regulations are adopted without any assessment as to their impact on industry and often impose costs on vehicle manufacturers that outweigh the anticipated benefits. In some cases, such as with emissions and CO_2, they place conflicting demands on industry which are impossible to reconcile.

36. FMC believes the European Union and national governments need to strive to achieve a better balance in assessing the economic, social and environmental impacts of newly proposed legislation. FMC recommends that all proposed EU regulations should be subject to a detailed cost/benefit analysis conducted by an independent body. This autonomous body would have to be created as part of a new EU treaty. Further, the EU Competitiveness Council should be given additional responsibilities. It would be helpful if the Competitiveness Council had the right to review all draft proposals for new regulations impacting on industry before being formally adopted by the Commission.

37. If a detailed cost/benefit analysis does not justify the proposal going ahead in its existing form, the Competitiveness Council should be empowered to have the proposal changed by the European Commission.

38. FMC supports the Society of Motor Manufacturers and Traders ("SMMT") call for the European Commission, the British and other EU Member States' Governments to improve their vigilance in ensuring a more uniform implementation of EU legislation in other countries so that British-based businesses are not disadvantaged as a result of incomplete or non-implementation in other Member States.

Taxation issues

39. Company Car Taxation—As indicated earlier in this submission, the British home market is vital to FMC's businesses, both as regards "Blue Oval" and Jaguar and Land Rover sales. However, the UK is the only EU Member State with a company car taxation system based upon CO_2. The switch to the new system in 2002 has led to an absolute increase in the cost of running a car for company car drivers. This unilateral action is particularly damaging to the competitiveness of Jaguar and Land Rover, and also to Ford of Britain.

40. This cost will be compounded by a further reduction in tax thresholds for 2005–06, though FMC welcomed the fact that the reduction was limited to 5g/km as announced in the 2003 Budget. FMC has supported the Government's review into the impact of company car taxation on the market, but believes a period of stability is now required to allow the system to bed down. No further changes to the system should be made until the Inland Revenue has completed its evaluation of the impact of the recent company car taxation changes, and its findings discussed with the automotive industry.

41. Vehicle Excise Duty—The introduction of a graduated VED system has provided a clear signal to motorists about the importance of CO_2 emissions. The scheme introduced in March 2001 has been subject to revision in 2002 and 2003 with the establishment of additional bands for vehicles with CO_2 emissions below 120g/km and 100g/km respectively. These changes reinforce the target established in the Government's Powering Future Vehicles strategy that by 2012, 10% of new car registrations would have CO_2 emissions below 100g/km.

42. Given the recent changes to the VED, FMC believes there should be a period of stability and no further changes to the VED system in the short-term.

43. Fuel Duties—The revalorisation of fuel duties announced in the last Budget took effect from 1 October 2003. The Chancellor has also committed to the introduction of a 0.5 pence differential for sulphur-free fuels from Sept 2004. Whilst FMC supports the Government's encouragement of zero sulphur fuels, especially as it can have an immediate effect on reducing the historic parc's tailpipe emissions, a 0.5 p/litre incentive is not enough to give widespread fuel availability as required by the EU for 2005.

44. Although FMC welcomed the three-year plan for fuel incentives outlined in the Chancellor's pre-Budget statement in December, the planned erosion of the incentive for Liquefied Petroleum Gas—taken together with the recent concerns over LPG product funding via the Energy Savings Trust's PowerShift scheme—will negatively impact on the viability of OEMs providing LPG vehicles in the British market. Whilst the CO_2 savings benefit of LPG is not significant compared to diesel, it does provide CO_2 savings over petrol and an 80% reduction over diesel in terms of other emissions, such as NoX and particulates. A move to a mono rather than bi-fuel vehicle fuel system (ie, LPG exclusive rather than a diesel or LPG option) would also improve LPG CO_2 reductions by around a further 10%.

45. Corporation Tax—Capital allowances at a 25% disclaimable level are vital to FMC given its intensive UK manufacturing bases and cyclical businesses. The capital allowances are available on qualifying expenditure on plant and machinery—with the ability to disclaim those allowances in loss making years. Such allowances are viewed as an incentive to invest, largely because they are front-end loaded.

46. Eliminating the flexibility to disclaim plant and machinery capital allowances would accelerate and increase tax liabilities, resulting in increased uncertainty in terms of the rate to be used and discouraging inward investment. Therefore, Ford Motor Company warmly welcomes the Government's decision following the corporation tax reform consultation not to replace capital allowances with uncertain book depreciation that could be distorted by unscrupulous accountants and International Accounting Standards.

47. Pension provision—Under the Government's proposed pension protection fund, companies operating defined benefit pensions would be charged a compulsory levy to establish a compensation scheme. There are serious business fears that the levy will further undermine pensions by penalising prudent companies by making them responsible for those companies that are not. There is a danger this could accelerate the move away from defined benefit schemes destabilising pension provision and undermining business commitment to their maintenance.

48. FMC urges the Government to carefully assess the impact of its proposals on pensions and competitiveness before imposing new burdens on companies. Any changes should not negatively impact companies providing good pension provisions for their employees.

49. Private use of commercial vehicles—The Society of Motor Manufacturers and Traders' submission to the consultation on the private use of commercial vehicles has provided the Inland Revenue with a detailed response to its review of the benefit in kind taxation of employer provided vans. In its comments, the SMMT stressed that industry had found the existing approach straightforward, transparent and broadly appropriate.

50. FMC is keen to ensure particular classes of commercial vehicle or body types are not presented as more of a private benefit than others. Any benefit is determined by access and use of the vehicle, not the vehicle's specification. The automotive industry takes its environmental responsibilities seriously and places a high priority on improving its products. However, FMC does not feel that changes to van tax would create any extra incentives for employers to make choices more based on environmental considerations.

51. R&D Tax Credits—FMC welcomes the proposals in the December 2003 pre-Budget statement on R&D tax credits. Overall, the consultation process has worked well and Government has listened to and acted on recommendations to produce some positive enhancements to the regime.

52. In particular, FMC supports the proposals for revised definitions outlined and the expansion of the qualifying cost base to include all R&D utility costs, as well as software costs directly attributable to R&D activity. The confirmation that specially commissioned R&D prototype costs should attract credits is also welcomed, as the testing of prototypes is a substantial product development cost in the automotive business.

53. FMC would also like to see the Government demonstrating a long-term commitment to the incentivisation of R&D with minimal administration or compliance burden for taxpayers. Future actions should avoid any erosion or dilution of the current regime's scope or value—whether by legislative restriction or practical limitations on audit of claims by the Inland Revenue.

Regulation and automotive industry competitiveness

54. Plant Efficiency—The global automotive market is acutely competitive and FMC like other vehicle manufacturers, has to compete every day on quality, delivery and cost performance. Over the past eight years, for example, the number of products competing with Land Rover in the SUV market has more than doubled. FMC plants in the UK have made real progress in delivering improvements in efficiency and working practices but this is a continuous process and success in this area will determine the future prosperity of the industry and secure jobs.

FMC and Britain's entry into the Euro

55. FMC regards Britain's entry into the Euro as being in the long-term interest of the country as it will provide stability, make it more attractive to inward investment and will help to maintain long-term competitiveness.

56. FMC continues to support British early entry into the Euro at a competitive exchange rate or, alternatively, at an exchange rate that does not position the British economy at a long-term disadvantage versus its Eurozone peers.

57. FMC welcomed the Chancellor of the Exchequer's response to the Five Key Economic Tests in June 2003 as it has provided a roadmap for Britain's entry into the Euro at some point in the future.

Initial effects of Block Exemption changes

58. The new EU Regulation, No 1400/2002, relating to the distribution and servicing of motor vehicles in the European Union, came into effect on 1 October 2002, allowing for a 12-month transition period. The Regulation has opened up the automotive sales and servicing distribution networks in order to increase competition in the market.

59. FMC has implemented the new Regulation and, as a result, the dealer networks across all of the Ford group brands have migrated to new dealer agreements (covering vehicle sales, repairs and parts).

60. However, it is the case that small independent dealers offering service and choice for rural customers are leaving the industry. This concern was raised during the Block Exemption consultation process, and there is now empirical evidence to support this opinion.

61. While the profitability of larger dealers is on the increase, as was also predicted in the Block Exemption consultation process, there are also now clear indications of a move towards the potential consolidation of large dealer groups. This could result in the creation of dealer "super groups" with extensive territorial coverage and large volume sales.

62. Such a situation could see both inter and intra-brand competition decrease. This strengthened market control of a smaller number of "super groups" could lead to less choice for consumers in terms of choosing where to buy or service their vehicles, and might result in a decline in product availability as dealers opt to sell only those vehicles with higher profitability.

Regional Selective Assistance

63. FMC has benefited from the British Government's assistance over the years in gaining access to Regional Selective Assistance, including recently over £23 million to support an ongoing $425 million investment at the Bridgend Engine Plant to build a new six-cylinder inline engine for use in Premier Automotive Products.

64. RSA is a significant consideration when deciding on future investment decisions. It is important that the British Government continues to provide competitive RSA support to ensure the continuation of foreign direct investment, especially given the growing competition for automotive investment not only from

existing EU Member States but also from the EU accession states and from outside Europe. Should this challenge not be met, Britain will find itself at a competitive disadvantage in securing foreign direct investment in the future.

New Car pricing

65. According to the Office of National Statistics, the price of new cars in Britain fell by 2.9% in 2000, 4.4% in 2001 and 0.8% in 2002. In 2003 there was a reported 0.8% increase in prices, the first rise since 1998. Prices for Ford cars in Britain over the past six years have also fallen in real terms—despite significant improvements in vehicle specifications to meet customer demands and legislative requirements.

66. Britain has now become one of the cheaper markets in Europe, which reflects the substantial change in the Euro/Sterling exchange rate.

24 February 2004

APPENDIX 5

Supplementary memorandum by the Ford Motor Company Limited

JOB LOSSES AT DAGENHAM DUE TO THE ENDING OF CAR MANUFACTURING

At the oral evidence session on the 30 March 2004, Linda Perham MP asked the Ford of Britain Chairman, Roger Putnam, if Ford could provide details of the number of job losses on the Dagenham Estate due to the cessation of vehicle manufacturing. I am replying to the committee in response to Mrs Perham's information request.

Some 2,700 employees left Ford between July 2000 and February 2002 as a result of the ending of Ford Fiesta production. As with all separations from Ford employment since 1967, the Dagenham job reductions were achieved solely through voluntary programmes. In addition, the separation terms offered to departing Dagenham employees were industry-leading.

Around 500 Dagenham Vehicle Operations employees were redeployed to the Dagenham Engine Plant. Of this number, some 250 were new jobs created by production volume increases at the plant.

While cars may no longer be built at Dagenham, it remains a major production centre for Ford. Dagenham is still London's largest industrial complex, employing close to 5,000 people. Of the $600 million invested at Dagenham since 2000, $500 million has been focussed on diesel engine engineering and manufacture, and the plant is now Ford's global centre of excellence for this important engine technology.

John Gardiner
Manager, Government Affairs

5 April 2004

APPENDIX 6

Memorandum submitted by Phoenix Venture Holdings

PHOENIX VENTURE HOLDINGS (PVH)

1. Phoenix Venture Holdings (PVH) is an independent, medium-sized, British-owned company with approximately 6,000 employees. Following BMW's decision to dispose of Rover Group in May 2000, PVH acquired MG Rover Group. Based at the Rover site in Longbridge, PVH's mission has been to create a successful, profitable and sustainable business, building outstanding cars for personal and for fleet use. Its management is implementing this vision with determination and realism in what are challenging times for the UK's manufacturing sector.

PVH STRUCTURE AND PERFORMANCE

2. PVH works across the automotive sector through various companies. The major businesses within the Group are:

- MG Rover Group, acquired from BMW in 2000, this is the main company within the group which produces 11 car models, giving the group a presence in the small, medium, large and sports car markets;
- Powertrain Ltd, acquired in 2001, it produces diesel and petrol engines and transmissions for use by Rover and MG as well as external companies including Land Rover and Lotus;

— Xpart, established as a separate company in 2002 to supply and distribute car parts for the aftersales market (crash repair, maintenance etc) and to develop supply businesses for other, third party, customers;

— MG Sport and Racing, operates as a motorsport company, which provides specialist high performance products, marketing value and engineering knowledge that can be deployed across the group;

— Phoenix Distribution Ltd, this company has the distribution rights to Tata utility vehicles (Safari and Pickup).

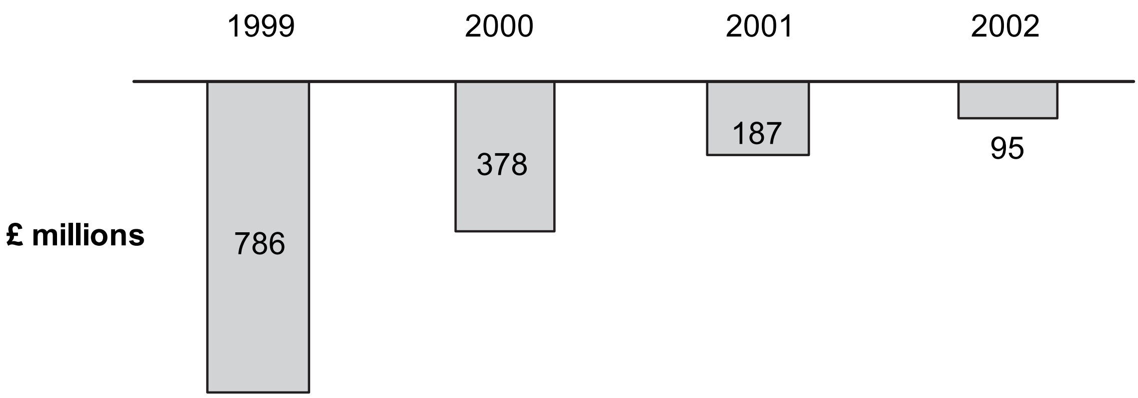
3. These businesses each have a specific commercial focus. They work as independent companies within the Group to provide maximum scope for their management to identify and exploit distinct business opportunities and to pursue operating efficiencies. In those businesses where it is planned to develop a greater level of third party business, it is a distinct commercial advantage to be able to display a degree of independence from a competing vehicle manufacturer. This is an approach that is perfectly usual within the automotive industry worldwide. They are now profit centres with their own business plans, for which they are accountable to the Group. In turn, each company also benefits from being within the PVH umbrella which can provide financial, information and other support that enables each individual operating company to be mutually supported by the activities of other parts of the Group.

4. In the year ending December 2002 (the last for which audited figures are available) PVH's turnover stood at £1,741 million. It recorded a loss of £95 million, which halved the previous year's losses. This continues PVH's significant progress in transforming the financial position of the business. Overall progress made by PVH in reducing losses since BMW's divestment of MG Rover is shown in Fig 1.

5. Audited financial data for 2003 is not yet available. PVH is confident that the figures will show further reductions in the overall group loss for the year.

6. Total car retail sales were circa 145,000 units, in 2003. This is broadly comparable with the previous year. MG Rover accounted for around 3.7% of the total UK car market in 2003.

Fig 1. PVH Loss Reduction



7. Our European market volume has been affected by two major factors: firstly, the need to partially unwind the MG Rover dealer network from the formerly integrated Rover/BMW/Land Rover set-up, and secondly, our decision not to sell vehicles at a loss, due to the unfavourable exchange rate. These factors have had a big impact on our European dealer network and, therefore, volume potential. The European network is now on a firm footing and looking forward to sales launch of new models.

8. PVH has also been pleased to report very positive developments on the product side. The Group has launched nine new models since it took over MG Rover in 2000. This has included a range of MG saloons, Streetwise (based on the Rover 25) which is designed to appeal to younger drivers as well as the MG TF, which was voted the "World's Most Beautiful Cabriolet" at the Milan motorshow by some of the world's leading designers. We are delighted that the MG TF has subsequently become the UK's best selling roadster. At the very top of the range, we were also proud to launch the XPower SV, a high performance sports car, which went on sale in November 2003. This year MG Rover Group has already launched a newly designed Rover 75 saloon and Tourer together with MG variants. With a view to changing consumer environmental concerns, Powertrain added to PVH's overall product range with the introduction of a range of Liquefied Petroleum Gas (LPG) powered vehicles.

Building a Sustainable Business

9. Developing PVH's automotive businesses, in particular MG Rover Group, into sustainable long-term concerns is a significant strategic challenge. Our approach has not been to create a narrowly based sports car provider, an approach that was advocated by other prospective purchasers of the business. Our goal has been to maintain higher volumes by developing a multi-niche approach. The business model has been to offset risk by not relying on a single brand but developing a portfolio of products.

10. The UK car sector is dominated by global car manufacturers (such as Ford, General Motors and certain Japanese companies) producing for the mass market with huge marketing and research and development budgets. These manufacturers are able to generate substantial economies of scale because of their geographic reach and ability to stretch investment in platforms to a wide range of different models, whose primary differentiation relates not to underlying engineering but branding and cosmetic features. At the other end of the market, the UK car industry is also populated by very small niche providers. These tend to build specialist models, often sports type cars and often in very low volume.

11. PVH's approach seeks to build a sustainable business model based on far higher volumes than most niche providers—but at a much lower level than the global production of the dominant industry players. Delivering PVH's strategy depends upon developing a market presence with a number of models to generate economies of scale that reduce costs across the range. These economies accrue from an enhanced ability to run production facilities at higher volumes (because the line can be switched between models) and by using common components across various models. PVH's attempt to sustain a "one-site" high volume business model has not been replicated elsewhere in the UK. However, PVH believes that its approach at Longbridge has a unique potential to succeed. Key factors in facilitating this include:

- significant brand value in the Rover and MG brands, which provide strong ongoing marketing potential;
- a high-base of investment in the Longbridge site which has allowed us to exploit and develop state-of-the-art facilities, usually only available to a global player; and
- the expertise of Longbridge's local skills base, which has been built on and developed with world-leading engineering and design talent.

12. Even with these advantages PVH's management still faces a challenging task. The baseline situation it inherited was not ideal. BMW would not have divested if that were the case. The key management priority has therefore been to find new ways of sustaining and growing the existing business in an extremely challenging commercial environment. Its approach has been characterised by its drive to seek:

- Cost productivity/efficiency gains.
- Effective collaboration.
- Product Development.

Cost productivity/efficiency gains

13. Improving MG Rover Group's cost efficiency and productivity has been a key objective since PVH's acquisition. Significant strides have been made in this area. This has included, for example, the location of all manufacturing and in-house component manufacture operations on the Longbridge site. The process of consolidating production at Longbridge was a major operation, involving major technical and logistical challenges. This included the transfer of the Rover 75 production line from its previous base in Oxford and transferring existing new Mini production facilities from Longbridge. This was a massive undertaking that was completed with stunning success. The entire R75 relocation was completed on time and on budget to a 12-week schedule. Rover 75s are now produced at Longbridge at higher levels of efficiency and to more stringent quality standards than were achieved under BMW's management. The importance of this should not be underestimated. It has been crucial in protecting MG Rover Group's brand values and maintaining confidence (among key stakeholders such as the dealer network, suppliers and employees) in the future of Longbridge.

14. The redevelopment of the production side was accompanied by additional business consolidation to improve performance. This included moving all marketing and sales functions to Longbridge as well as quality control and testing functions. MG Rover Group is now a stand-alone operation with all support services on site. Other PVH businesses are also located there making Longbridge a true corporate headquarters.

15. PVH businesses, including MG Rover, have also extended their supplier base. Part of this has included seeking supplies from overseas. Our preference is to seek supply from the UK if possible, particularly where we have built up long term relationships. PVH nevertheless does have to be cognisant of commercial realities. Our priorities must be cost and quality. We are pleased that PVH continues to source 75% of its components from the UK. However, we are always examining how we can make component supply more efficient and cost effective and our sourcing policy is under constant review to ensure PVH's core businesses are able to operate at optimum efficiency. We cannot ignore the fact that many component

and sub-assembly supplies from abroad can be imported at an average of 25–30% lower prices compared to UK-sourced supplies. Maintaining effective supply of components is a crucial element in securing the long-term future of car manufacturing in Longbridge.

16. We continue to build long-term relationships with world class suppliers and contractors. This included XPart agreeing a 10-year partnership with Caterpillar Inc for logistics support, which has helped its ongoing sales and profitability growth.

17. PVH's efforts to increase labour productivity and capability have been greatly assisted by a constructive relationship with our workforce. For example, flexible working practices currently operating on the three main production lines at MG Rover Group mean that we are able to flex our output by up to 20% to match changes in demand. This is particularly helpful in an industry that is subject to significant seasonal variations. The changes introduced have been significant. When PVH acquired MG Rover Group production line staff did one job. Now these same workers are able to do five. This helps line flexibility but also benefits the workforce by increasing their skills set, providing variety in their work and, ultimately, supporting their continued employment. The development of skills on the site has been a substantial contribution to productivity and efficiency and is one of the key achievements delivered. Since May 2000 an improvement of c.30% in labour productivity has been realised.

Effective Collaboration

18. Collaboration is a vital component in PVH's strategy. Our management is consistently evaluating opportunities to develop relationships that will enhance its ability to compete both in the UK and internationally. Strategic relationships with other companies have been invaluable in helping PVH fill gaps in its product range and open new markets. Applying MG Rover "DNA" and our engineering standards to existing platforms already developed by other manufacturers has helped significantly reduce the costs of bringing new models to market.

19. Our partnership with Tata, the Indian conglomerate, exemplifies this approach. Tata and MG Rover Group collaborated to develop the new CityRover model, a small car that brought MG Rover Group back into an important sector of the market. The car, based on the Tata Indica platform, is manufactured in India to MG Rover Group's design and engineering standards. It is sold throughout Europe, including the UK, by MG Rover Group's dealer network. This creates an income stream to support MG Rover Group's core activities. It also supports the dealer network, providing direct financial benefits and supporting the Rover brand. While this particular venture does not directly support manufacturing specifically in Longbridge, it is an invaluable component in maintaining MG Rover's competitive position and creates positive knock-on effects for cars actually built at Longbridge.

20. PVH was also pleased, earlier this month, to sign a letter of intent with Proton, a car manufacturer based in Malaysia. This signals our intention to explore the feasibility of a number of potential collaborative projects, many of which have detailed discussions underway. Partnerships such as these will continue to be an important aspect of sustaining and developing PVH businesses at Longbridge.

21. The benefits of a collaborative approach are significant and diverse, providing knowledge transfer, the potential for new product lines and the opportunity to open up new export markets. There are, of course, risks involved. MG Rover Group was working in partnership with China Brilliance. The collaboration was at the time a fundamental element of our plans to introduce a new medium sized car. Unfortunately a major dispute between the owner and the Provincial Government resulted in China Brilliance's inability to complete the project. This created significant disruption to MG Rover's plans. This was followed by our major engineering partner, TWR, going into receivership and together with the China Brilliance issue this caused a major delay to the introduction timing of the new medium car.

22. One partnership that is fundamental to the long-term success of MG Rover is the relationship it has with its dealer network. We are delighted to say that we have been able to sustain a committed and vibrant network since 2000. We currently have 270 dealers within the UK and are hoping to strengthen our presence by around 10% over the next year. Apart from the headline growth expected we have also been actively managing distribution within the existing network. This involves, for example, replacing dealers within the existing network where their performance has been below target. This boosts overall performance by finding more effective dealerships and better sites. We also supported our dealer network by negotiating an agreement to provide dealer wholesale and retail financial services in the UK. This service is now provided by Capital Bank (part of Bank of Scotland). Similar agreements with other providers of vehicle financing have been reached in other major markets to assist dealers. New opportunities regarding the dealer network may also be emerging because of the recent reform of the Block Exemption legislation applied to car distribution. There is now the prospect for all dealerships to consider franchise extension. MG Rover Group is already aware of some expressions of interest in this area and is examining the potential offered by this opportunity.

23. It has already been noted that PVH's relationship with its workforce has increased its operational flexibility. This has relied on effective partnership. One key element of our collaboration with the staff has involved training. The training provision has been recognised as "Best-in-Class" by the Adult Learning Inspectorate, which has designated the Young People Development Scheme as "Outstanding", by the

Birmingham and Solihull LSC as "Excellent" and by the DFES which awarded the Company "Beacon Status". There are very strong links with Dudley College, which has an annex on the Longbridge site, and the University of Central England, which notably has jointly developed an MSc in Leadership and Change Management. The training is very practically biased as evidenced by over 1,000 production operatives having an NVQ Level 2 qualification, Performing Manufacturing Operations. In each of the last two years there has been, on average, more than one training intervention per employee. A crucial theme has been transferring the learning to the supply chain, dealerships and the local community. Our ultimate aim is to improve quality standards to ensure that learners are getting the best possible education and training. This benefits our staff and the company.

Product Development

24. The introduction of new models and the development of replacements for older versions, is an important strand in PVH's strategy. The extension of MG Rover's small car range with the introduction of Streetwise, a new and innovative product based on the Rover 25 platform, and CityRover exemplify this approach. Similarly, significant strides are being made towards finalising development of a replacement for the Rover 45. This model will, on completion, provide significant new opportunities for growth and be an important component in securing a sustainable future for all the businesses within the PVH group. Over £100m has already been invested in this model up to the end of 2003.

25. Other opportunities for product innovation are also being developed. Apart from in-house development and manufacturing joint ventures PVH has also branched out into distribution deals. It currently does not make utility vehicles, which are an important component of the overall car market. Phoenix Distribution Ltd was created to distribute Tata utility vehicles in the UK and Ireland. This introduced updated versions of Tata's Safari 4x4 off-roader and the Loadbeta pick-up truck. These vehicles are being sold via a network of around 45 Phoenix Distribution dealers. This programme not only provides profit that can support the overall activities of PVH, it has also identified new, simpler, cost effective ways of managing distribution in a relatively low volume environment that PVH intends to read across to its other operations where appropriate to help enhance overall business performance.

26. PVH is also keen to exploit business diversification and this has been evident in Powertrain and XPart, which have both been seeking new third party customers and new markets for their products. Indeed, the acquisition and creation of these semi-autonomous companies is a highly significant development for the Group.

Economic Impact of PVH

27. PVH is keenly aware of the impact that its operations, particularly MG Rover, have on the local economy. We are also aware of the Committee's own desire (expressed in its report BMW, Rover and Longbridge) to see large-scale manufacturing continue at the Longbridge site and for this activity to continue to support jobs directly and in its supplier base.

28. In this context it should be noted that, across the group, PVH directly employs over 6,000 people. PVH also supports indirect employment in a wide variety of UK suppliers. In 2003, for example, MG Rover Group and Powertrain purchased £850 million worth of materials from within the UK. It also purchased some £275 million worth of other goods and services. (Using a conservative multiplier we assume that PVH's operations in turn help support a further 30,000 throughout our supply base). In total, since PVH assumed control of MG Rover Group, we estimate that we have spent some c.£6 billion in total on sourcing services and components, and the vast majority of this expenditure will have been made in the UK.

29. We have no doubt that the continued existence of a volume manufacturing operation at Longbridge has a significant and substantial benefit to the local and national economy. It is, therefore, worth noting also that £450 million, a significant sum, has been raised for the Government from PVH, its dealers and employees through the payment of various taxes (including income tax, NICs, Rates and Vehicle Registration Fees). In addition, PVH has exported c.£2 billion worth of vehicles.

Supporting the UK Automotive Sector

30. The evidence above illustrates the range of activities PVH is engaged in within the automotive sector. These mutually supportive operations are steadily bringing it towards break even and sustainability. Even so, as with any business, government activity has the potential to either help or hinder PVH's efforts. The Government's objective should be to minimise the obstacles it presents to the UK automotive sector and provide as much positive assistance as possible. PVH recommends that this should involve:

Curtailing unfair state aid in Europe:

European Union rules constrain the provision of state aid. The British Government adheres strictly to this legislation. We fear that some of its EU partners may not be so principled in respect of aid provided to the automotive industry. Given the portability of operations, multi-site operators are adept at playing one member state against another when it comes to extracting from them the most generous packages of assistance. This puts a single-site operator such as PVH at a significant disadvantage. Inappropriate aid to motor manufacturers will unfairly support the competitive position of our direct competitors. The Government should proactively seek to expose and encourage the Commission to prosecute such practices. If these practices cannot be prevented it should consider if there are other ways in which it could even up the playing field.

Euro entry:

For much of the last decade UK manufacturing has had to compete in a European market characterised by a weak Euro/strong pound. In a highly competitive market this has made winning export orders more challenging and squeezed or eliminated profit margins. In the second half of 2003 it appeared that a strengthening of the euro might finally enhance UK manufacturing's export opportunities. Unfortunately recent Euro/pound exchange rate conditions have again deteriorated. Uncertainty in respect of this exchange rate relationship harms the ability of UK businesses to develop effective European strategies. Unlike their Euro Zone competitors, UK exporters have to be prepared to accommodate significant exchange rate risk, which places them at a very real competitive disadvantage. At a minimum the Government should finalise its position on Euro entry. Ideally it should make clear plans to enter the Euro at the earliest possible opportunity.

Trade assistance:

Saturated/mature western markets, with high levels of competition, offer restricted growth opportunities. Other less developed markets present greater commercial opportunities. One of PVH's strategic decisions has therefore been to explore prospects for collaboration and market development in the Far East, including China. These markets offer potential for significant volume growth and opportunities to share product development costs and reduce component supply costs. Developing these opportunities does, however, involve overcoming significant political and cultural barriers. UK Embassies in relevant countries are often very helpful in tackling these problems. However, more could be done. A market like China, for example, attracts attention from many companies in many sectors. The process of finalising deals is subject to unique complications given layers of government at local, provincial and national levels. Significantly more direct assistance could be given to UK companies trying to negotiate the political and regulatory obstacles inherent in developing these opportunities. A proactive approach should also be taken to ensuring that companies of all sizes—not just the largest multinationals—are afforded the level of support they need.

Engineering and regional support:

Our major interaction with the wider UK automotive sector lies in the purchase of components. It is, however, becoming increasingly unattractive to source components within the UK for reasons of investment levels and unit costs. Serious consideration should be given to measures to make UK supply more competitive. One route would be Government support for improved skill development in the engineering sector. As we have seen within PVH, effective training and skills enhancement can be instrumental in enhancing efficiency, reducing costs and, ultimately, increasing competitiveness. Another route might involve developing incentives to ameliorate the capital costs of tooling for UK-specific supply. Clearly, this type of assistance would have to be carefully developed to ensure it complies with state aid rules. However, a creative approach in this area could pay dividends in supporting the wider automotive sector and protect the very infrastructure of the UK component supply industry.

End of Life Vehicle Directive implementation:

The DTI's approach to ELV is supported by MG Rover. While it is not ideal and presents commercial risks for MG Rover group, the "own marque" approach is likely to be the most competitive, and therefore, cost efficient and practical implementation system for take-back and recycling. It is now up to individual manufactures to establish how to best deal with the recovery industry process. MG Rover Group, with around 11% of the ELVs arising in 2007 is obviously disadvantaged by the Directive given the historical responsibilities it has to assume being much larger than the size of business that it now is, but at least it is well placed to enter into a sensible long-term contract with a service provider on the basis that it will provide them access to a significant aluminium rich feedstock through their network. However, the DTI must take an ongoing role to ensure that the criteria to define the "adequacy" of the producer-contracted networks are not excessive in comparison with that of other European countries.

Conclusion

31. PVH has made major progress, not all of it immediately visible to the outside world. All 6,000 of the PVH employees have played a major part in our achievements to date. At the time of the initial purchase, no one involved in the business was under any illusions about the scale of the challenges facing the company. An additional challenge has been the fact that stories about MG Rover always make for more sensational copy if they portray an imminent collapse rather than steady progress. There have also been some setbacks along the way, including the collapse of the China Brilliance JV and TWR going into receivership. Moreover, whilst the UK market, where MG Rover sells two thirds of its cars has been buoyant this has in part been driven by the contraction in volumes in other European markets. Coupled with the exchange rate benefits which Euro-based manufacturers have enjoyed for most of the past four years, the pressure on UK margins has, therefore, been intense.

32. Finally, PVH recognised that it could not pursue the conventional business model followed by other volume car producers. It was, indeed, such a conventional approach that was unable to provide a viable strategy for the old Rover Group. PVH simply does not have the resources to do things in line with those normal industry practices. Instead PVH has addressed the challenges it faces by adopting a new strategy that enables it to react more quickly, more cost effectively and in line with the limited resources at its disposal. PVH's goal remains the pursuit of these alternative routes in order to secure the future for all of its businesses and stakeholders.

APPENDIX 7

Supplementary memorandum by Phoenix Venture Holdings

Performance of the UK's Automotive Sector

I am writing to supplement our evidence to the Select Committee's inquiry into the UK's automotive industry.

Firstly, in the light of recent media coverage I thought it would be helpful to briefly detail the role of Techtronic (2000) Limited in our company's structures. When the Phoenix Consortium was successful in its bid to buy MG Rover Group from BMW in May 2000 it required an acquisition vehicle to do so. In line with normal business practice it used an "off the shelf" company, Techtronic (2000) Limited and this became the holding company for MG Rover Group and Powertrain Limited which it acquired 12 months later. Techtronic (2000) Limited does not trade and remains in place in relation to the deal with BMW, holding the loan note from them. This structure does not materially affect the implementation of PVH's strategy to build a sustainable future for Longbridge. Other key operating companies within the Group (as detailed in our original submission) have been acquired since this initial acquisition. This structure maximises the operating transparency of the Group's activities and allows management to more effectively identify cost savings and commercial opportunities.

Secondly, this week has also seen our attendance at the Geneva Motorshow and I am enclosing copies of our press pack [*not printed*] which outlines the plans for a new 75-derived top-of-the-range Rover V8 saloon from MG Rover Group and a higher powered version of the sports car the MG XPOWER SV-R from MG Sport and Racing.

I hope this is of help to the Committee.

Kevin Howe
Group Chief Executive

8 March 2004

APPENDIX 8

Memorandum by the Retail Motor Industry Federation

The Retail Motor Industry Federation (RMI) represents the interests of retail businesses within the automotive industry, one of the largest industrial sectors in the UK, employing 600,000 individuals. With 10,000 member companies spanning petrol retailers, small garages, medium-sized businesses and large groups, the RMI is one of the UK's biggest trade bodies.

As the RMI represents motor retailers and repairers we would like to raise issues relevant to the third item detailed in your press release; "Developments in vehicle sales and distribution, servicing and customer support."

BACKGROUND

The RMI last met with your Committee to discuss new car sales and pricing in October 1998 and April 1999. In 1998 you reviewed Vehicle Pricing and in 1999 Grey and Parallel Imports. At that time the UK was perceived as the most expensive new car market in Europe, and "Rip Off Britain" was a phrase frequently used in the media.

Since then we have seen a significant change in the new vehicle market brought about by some key factors. Firstly, in 1999 and 2000 we saw a dramatic increase in the level of parallel imports from mainland Europe. This growth was undoubtedly driven by consumer dissatisfaction with UK prices and the publicity arising from your high profile inquiries. Many car brokering companies, some less financially secure than they should have been, were established and in the short term prospered, brokering import deals for UK customers.

Secondly, we saw the implementation of the Supply of New Cars Order 2000. The Secretary of State for Trade and Industry put this regulation in place to limit the vehicle manufacturer practice of pre-registering cars to sell cheaply rather than publish lower new car list prices. It also required vehicle manufacturers to offer dealers similar deals to those offered to Fleet Purchasers subject to similar volume criteria. The regulation caused vehicle manufacturers to review their UK pricing policy and consumers were soon offered lower new car prices. As a result we saw the start of a period of market growth that has continued until now.

Thirdly, the European Commission approved a new Block Exemption Regulation 1400/2002 effective from October 2002 with a further amendment due in October 2005 and an end date of May 2010. The new regulation has given dealers greater freedom to source and retail cars throughout the European Union, opportunities to multi-franchise their businesses if they so choose, opportunities to expand their after-sales activities and from October 2005 opportunities to expand their vehicle sales areas of responsibility. Additionally the regulation requires vehicle manufacturers to publish criteria applicable for independent repairers to become Approved Repairers and also to create greater accessibility to technical information.

There are areas which caused concern in 1998 which are still impacting on consumers and new car dealers.

Competition

"The control exercised by manufacturers over dealers' margins has taken the possibility for varying the invoice price out of the dealers' hands. Whilst any explicit price setting would be illegal, the nature of the relationship between manufacturers and dealers means that manufacturers have considerable power over retail prices. In our view, the new car market would be more competitive if there was less power in the hands of manufacturers."

Manufacturers continue to limit dealer margins and as a result control absolutely the prices consumers pay for new cars. EC Regulation 1400/2002 has given dealers a certain amount more control over their own businesses but manufacturers have increased the cost of entry to and retention of a franchise by such a degree that dealers are severely limited in their ability to deal.

Fleet Cars

"Given the size of the fleet market, it would seem inevitable that fleet buyers will be in a position to negotiate substantial discounts; that the manufacturers seek to recover from other sales some of the profit foregone; and that as a result consumers find themselves paying for fleet discounts. This preponderance of new car purchases by fleet operators means that a single consumer can be at a competitive disadvantage."

The large discounts still available to large and not so large fleet operators continue to distort the market place. It is still our contention that it is wrong that a fleet buyer can negotiate terms that are significantly better than those enjoyed by our largest members who are buying more cars and have made an enormous investment in a franchise.

Servicing and Repair

"There is a general dissatisfaction with the services provided by garages and we have seen no evidence that franchised dealers are making any contribution to providing better customer service."

The RMI is currently working with the Department for Trade and Industry and the Office of Fair Trading to implement a new Automotive Code of Practice that will give customers greater confidence in motor sales and repair businesses. The new scheme will be known as the RMI CarWise Code and it is anticipated that this will be one of the first of the new Codes of Practice accredited by the OFT. The RMI and its members are committed to delivering good service to our customers and the new code will ensure that this happens in an auditable manner.

The RMI would be happy to provide further information if necessary.

Matthew Carrington
RMI Chief Executive

19 February 2004

APPENDIX 9

Memorandum by Professor D Garel Rhys, Director of the Centre for Automotive Industry Research, Cardiff University Business School

INTRODUCTION

The British car market in 2003 almost reached 2.6 million sales which was the third record year in succession. It is likely that 2004 will be similar and could be a new record at over 2.6 million. Indeed, January 2004 saw sales at an annualised rate of 2.8 million. The UK car market is the fourth largest in the world, which is not surprising as the UK economy is also the world's fourth largest. However, as 81% of these cars were imported this was mainly to the benefit of foreign car factories. Crucially over 69% of UK car production is exported and the recovery of car production from 1.2 million in 1991 to over 1.6 million in 2003 has been export-led as never before. Whatever the source of the sales the great hope is that in the near future the record production of 1.92 million cars reached as long ago as 1972 will be exceeded, and also that the 2 million production barrier will be breached.

THE AUTOMOTIVE SECTOR IN BRITAIN

As most of the significant vehicle makers and component producers in the UK are foreign owned, the motor industry in Britain is more representative of that in the rest of the world than the other major centres of vehicle making like the USA, Japan, Germany, France and Italy that have an indigenous industry. Although the industry in the UK covers all the main segments of the car market and commercial vehicle market, the fact that companies are foreign owned means it faces the same challenge as the automotive sector in most countries. They have to persuade international capital that they are worth investing in. So, bearing this in mind, what of the position of the UK as a vehicle making centre? The ending of car making by General Motors in the Vauxhall plant at Luton should not be taken as a sign of the total meltdown of the motor industry in Britain. Clearly coming hot on the heels of BMW's retreat from Rover, and the long drawn out closure of Ford's car assembly at Dagenham, this was one of a series of blows coming after a decade of climbing production and record exports. However the particular problems of these companies should not be translated into a general malaise. Even with a weak euro the UK can still be a good place to make vehicles and to place new investment.

The closures by Ford and General Motors removed a capacity potential of 460,000 cars on a two-shift basis. Even so, the expansion of Jaguar, Land Rover, Peugeot and BMW-MINI, together with the consolidation of Rover, Honda, Toyota, and Nissan, and the continuation of Vauxhall (GM) production on Merseyside, and the plans by VW for Bentley and BMW for Rolls Royce leaves enough productive potential to comfortably make 2 million cars a year (Table 1). This potential can still be turned into reality.

The growth of output since 1991 was reversed in 2000-1 but 2002 saw a strong recovery that was sustained in 2003 (Table 1). The really exciting thing was that potential standard capacity (which is about 85% of absolute capacity) (Table 1) allows room for further growth—a potential which could be realised in 2005–08.

Table 1

	Output ('000s)					*Potential Capacity*[1]
	1997	*1999*	*2001*	*2002*	*2003*	*2004*
MG Rover	395	226	163	147	133	200
Ford	302	255	73	13	—	—
PAG (Ford)	151	241	263	280	374	400
General Motors	285	339	194	137	134	200
Peugeot	85	163	186	198	207	230
Nissan	272	271	296	297	332	450
Toyota	105	179	155	212	211	250
Honda	108	114	113	177	185	250
MINI (BMW)	—	—	41	160	175	180
Others	10	11	9	9	9	20
Total	**1,713**	**1,799**	**1,493**	**1,628**	**1,657**	**2,180**

[1] At standard capacity: ie, sustainable annual capacity on which overhead costs are allocated.

[2] Figures may not add up due to rounding.

Output in 2003 of over 1.65 million was not too dissimilar to the 1.7 million achieved in 1997. A comparison of the two years shows the robustness of the "new" motor industry in the UK. In 1997, Ford, General Motors and Rover made 979,000 cars but by 2003 this had fallen to under 270,000. However, the decline of Rover and the closure of Luton and Dagenham has been fully compensated elsewhere. The huge growth in Premier Automotive Group output at Jaguar and Land Rover confirms Ford's continuing commitment to UK car production, whilst the growth at Peugeot, MINI, Toyota, Honda and Nissan is equally noteworthy. This recovery in output seems set to continue.

The high levels of productivity attained in the UK's Japanese car plants (Table 2) together with the substantial improvements elsewhere go much of the way to dealing with the euro-pound exchange rate and variations against currencies such as the US dollar and yen. This is important for the UK quality car sector given its reliance on the US market. The German reaction to a similar dependence is to manufacture in the USA. This lesson has not been lost on the volume makers, with Honda taking commendably quick action to re-orientate export sales and Toyota increasing volume to spread costs. In addition, and this is where the real threat lies to automotive employment, vehicle makers can give themselves a built-in hedge against currency re-alignment by reducing the British content of their British output and sourcing supplies abroad. In the recent past, the total UK content by value, of GM's UK production, including labour and overheads costs as well as components and materials, was only about 55–58%. However, the new Vectra made at Ellesmere Port now has an even smaller UK content of 45%. A UK-assembled Peugeot is around 51% British by value added. Honda is reducing its component sourcing from 70% British to 50% which in hard cash means the annual loss of £80 million of expenditures in the UK supply chain. Such a strategy can preserve jobs in the UK vehicle plants but at the cost of job losses in the component and supply infrastructure, including of course steel plants. However if foreign sourcing goes too far and the pound depreciates then such a policy can backfire. If production is moved abroad totally then similar difficulties result. In the latter regard the change in the pound-to-euro rate has badly affected Ford.

Table 2

LEADING PLANT PRODUCTIVITY IN EUROPE (VEHICLES PER EMPLOYEE) 2000

Rank in Europe	*Company*	*Plant*	*Performance*
1	Nissan UK	Sunderland	101
2	Toyota UK	Derby	86
3	Honda UK	Swindon	83*
4	Ford Germany	Saarlouis	81
5	GM Germany	Eisenhach	81

* Underlying productivity. Actual was lower due to model changes, etc.

The problems facing the UK component sector are not all due to exchange rate issues, although these can intensify them. The basic efficiency of too many component companies is insufficient, the size of operations is too small, investment in all areas has been deficient and of course commercial advantage may mean buying abroad. For instance, the reduction in the UK content of the new range of British built Leyland Daf trucks from over 70% to 52% was due to Renault winning the contract to supply, against domestic competition, the new vehicle's cab on straight quality and specifications issues. The exchange rate was not a factor. Therefore, it is important that the exchange rate is not used as an excuse to mask underlying problems.

Finally, competitiveness on the supply side of the equation is of little use, if unattractive and bland cars are the result. This is the lesson the Japanese are having to learn: quality of build and outstanding production per man is of little consequence if the cars are poorly received. Jaguar shows what is possible if attractive, efficiently made cars are sold with no exchange rate problem. In short lean production may be a necessary condition for commercial success and survival but it is not sufficient. The sufficient condition is the utilisation of lean methodology together with sufficient volume to obtain economies of scale to manufacture desirable products.

The particular problem facing GM in Europe was overcapacity and they partly addressed this mainly by closing Luton. But why Luton? Was it because of the pound, or the ease of closing plant in the UK or particular problems with Luton? In essence it was the latter, as the exchange rate problem was contained by the built-in hedge via foreign content. The plant was profitable and efficient within its own limits, but it was old, cramped, awkward and in the wrong regional location. At the same time GM had completed the modernisation of its main German plant for Vectra production. However it was soon realised that due to limited growth in the Vectra upper medium segment and increased competition, sales targets had to be revised downwards. There was too much Vectra capacity and Luton became marginal because of the prior modernisation in Germany. A crucial factor was that Luton was caught by timing: it had not been modernised for the new Vectra and Vectra targets were reduced. So, Germany won out.

However, once such problems reveal themselves it is undoubtedly easier to close a plant in the UK than in Belgium, Germany or Spain. Ironically the factors that are deployed to make the UK a good home for inward investment, all the things that add up to a flexible unregulated and agile economy, are also those that make it easy to leave. In the view of the economist there is free entry and exit. Clearly, if Luton had overwhelming advantages over other plants, the "free" exit question would not have arisen, but where matters are close to call it can become a factor.

The real significance of the GM decision is not whether the UK is still a good place to make vehicles. Rather it is the speed with which the multinational took action to address an overcapacity problem which had dire implications for its European profitability. Ford took ten years to come to grips with the same issue, GM took ten days. This was a wake-up call to Government and anyone else interested, that nothing can be taken for granted about the future of UK manufacturing. This has injected huge uncertainty into the equation, even if the UK remains a good home for vehicle making. In other words the market is a hard task master and as the UK illustrates, the vehicle makers will only invest where the prospects of a return are good.

Table 3

UK ENGINE MAKING FACILITY

	Output 1999	*Forecast Output 2005*	*UK Content*
Ford (incl Jaguar)	650,000	1,950,000	Moderate
Land Rover	200,000	250,000	High
Rover MG	290,000	200,000	High
GM	120,000	Possibly 0	Low
Nissan	280,000	450,000	High
Honda	80,000	250,000	Moderate
Toyota	120,000	250,000	High
Perkins	300,000	300,000	Moderate
Cummins	30,000	30,000	Low
BMW	—	400,000	Low
(i) Others (Tractors, construction equipment, marine, generators, etc)	40,000	55,000	Moderate (average)
(ii) Other (car)	5,000		
Total	**2,115,000**	**4,135,000**	

Source: Professor D Garel Rhys, Centre for Automotive Industry Research, Cardiff University Business School.

This has manifested itself in the manufacture of automotive engines. The combination of capital intensive techniques and plant efficiency has seen the UK become a major centre of engine manufacture with a promising future (Table 3). However, nothing can ever be taken for granted and within a positive industry-wide trend individual operations could still decline. This is probable as regards the GM engine plant in the UK where global company-wide developments may make the UK facility redundant.

Also the closure of Dagenham and Luton should not be seen as supporting the hypothesis that the future of car making in the UK will be based upon specialist cars with the demise of mass market products. The efficiency of the three Japanese producers, the success of Peugeot's operation and the refurbishment of Vauxhall's Ellesmere Port facility would suggest otherwise. In short, the UK, like Germany, can play host to both specialist and mass market producers. If this were not so, then the future of the UK car industry would rely on the Premier Automotive Group plus up to 20,000 vehicles a year made by the ultra specialist operations of independents (eg, Morgan, TVR, etc) and large companies (Bentley (VW) and Rolls Royce (BMW)). To call MG Rover and MINI specialist operations may be stretching the definition too far.

Commercial Vehicles

Until the late 1970s the UK had one of the strongest of the world commercial vehicle industries. Now this is a pale shadow of its former self and has no chance of duplicating the resurgence of the UK car industry. In international and, in some respects, domestic terms, the UK commercial vehicle industry is an also-ran.

Now the only significant part of the UK commercial vehicle industry is based upon light van production mainly by GM, Ford and LDV. The remaining heavy truck production is by DAF (owned by the US company Paccar, a very prosperous concern that in 2003 posted its 68th successive year of profits) in its Lancashire plant. This also makes Foden trucks. In addition Dennis Eagle make emergency vehicles and Optare and Transbus (formerly Dennis and Alexander) make buses and coaches.

In 2003 there were 282,000 light vans, 37,000 rigid trucks, 19,000 artics and 4,000 buses registered new in the UK. Of these just over 65,000 light commercials up to 3.5 tonnes gross weight, 7,800 rigid trucks, 2,000 artics and 1,500 buses were made in the UK. Although 57% of light commercial vehicles are exported and 36% of rigid trucks, very little else is. This, together with the minor role of UK made CVs, other than light ones, as import substitutes shows the reduced role of the UK commercial vehicle industry.

At the same time there is still a major CV supply infrastructure. Diesel engines are made by Cummins and Perkins whilst bus and coach body builders add over 50% to the final value of foreign buses and coaches sold in the UK. However, the supply sector is in decline as the foreign content of UK made trucks and vans increases. Only in the case of super specialist vehicles such as Oshkosh in Wales might some new additional capacity appear.

Conclusions

Although trading conditions in 2003 have been difficult and competition was intense, the sales plans of the companies involved a ramp-up of production in most of the UK car plants. This involved an advance on a broad front for, like Germany, the UK has a major specialist car making capability to add to the products made for the mass markets. The market for specialist products is growing worldwide as people become wealthier and want something different. This will underpin the growth of not only Jaguar and Land Rover but also Aston Martin, Bentley, and Rolls Royce. Similarly, and although in a quite different segment, this will support the unprecedented rate of growth from zero of MINI production.

At the same time 2003 saw an impressive performance by the mainstream producers in the UK. The plants of Nissan, Toyota and Honda are the most productive in Europe, but now they have the products to grab attention. The Japanese firms have learned the lesson that important as it is, production excellence is not enough. They must make desirable cars. At the same time Peugeot maintained a high level of production at its UK plant in an attempt to satisfy the excess demand for its product. General Motors is keen to unlock the potential of its refurbished and flexible plant at Ellesmere Port. MG Rover engaged in "holding the line" in 2003 awaiting its important new medium class car for mid-2005 launch.

The UK will see its position as a manufacturer of speciality and mass market cars consolidated in 2003–05. The UK is an efficient producer of all types of car. What the motor industry needs to do in 2004–05 is to increase its share of its home market to add to its excellent export record. The critical mass of first-rate products emerging from the British car factories in 2004 might see it do that, but the UK customers' demand for variety and choice militates against. Also given the growth in market segment the industry needs to make new superminis, and small medium people carriers like the Renault Scenic. The bottom line is that the desire for consumer choice will make the position of imports difficult to undermine. As a result the position of UK car making will depend on the continuing ability to export a huge proportion of production. This is a world where the UK customer wants foreign made cars and foreigners want UK built cars in record numbers.

APPENDIX 10

Memorandum by the Society of Motor Manufacturers and Traders Limited

Executive Summary

1. The Society of Motor Manufacturers and Traders (SMMT) welcome the opportunity to submit evidence to the Trade and Industry Select Committee inquiry into the UK Automotive Industry in 2004.

2. SMMT is the leading trade association for the UK motor industry. It represents some 600 member companies ranging from vehicle manufacturers, component and material suppliers to power train providers and design engineers. The motor industry is an important sector of the UK economy. It generates a manufacturing turnover approaching £45 billion and supports around 850,000 jobs.

3. The UK motor industry is committed to meeting the social and environmental challenges posed by widespread vehicle ownership and use. It has made significant progress in addressing safety, air quality, climate change and resource use issues. Vehicle manufacturers are working closely with their supply chains to ensure that vehicles continue to offer consumers choice and diversity.

4. The UK has enjoyed record levels of new vehicle registrations and production at UK plants has increased. The prospects for the coming years are positive, although increased output will depend upon economic growth in the major European markets. The UK is now a significant location for engine assembly and planned investments will see volumes increase. This provides an important opportunity for the UK.

5. The UK motor industry recognises that it must continue to improve if it is to compete effectively. It is working with government on a number of important initiatives that are helping to create a strategic advantage for the UK. SMMT Industry Forum is delivering leading edge productivity improvement to companies in the automotive supply chain. It is also passing on the lessons learnt to other sectors. The newly created Automotive Academy is helping ensure that current and future employees have the skills and training they need to succeed in the modern motor industry. The Foresight Vehicle Programme is now more closely linked to industry and focusing on the products and technologies that will be needed to meet future safety and environmental challenges.

6. The UK motor industry operates in an intensely competitive global marketplace. The UK has benefited from strong and stable economic growth, but government must continue to provide a tax and regulatory environment that is attractive to international companies with production facilities across the world.

7. There is increasing competition between locations for new investment. It is essential that government plays a more active role in promoting the UK to the global motor industry. There is concern that efforts by RDAs to encourage new investment are not sufficiently co-ordinated. The competition is between the UK and other countries not between different regions. There should be a more targeted approach with RDAs working within a broader national inward investment strategy.

8. The motor industry is under increasing pressure from national and European regulators to implement a wide range of technical legislation. SMMT is anxious to ensure that legislation is developed with industry and not imposed upon it. It would like to see independent impact assessments undertaken on all new EU regulation before it is progressed and the EU Competitiveness Council given a more direct role in scrutinising the economic impact of all proposals. When legislation is implemented in the UK, government must ensure that the burdens imposed are no more onerous than those in other EU member states.

9. The automotive sector recognises that success in the future will depend upon new product development and innovation. The sector has welcomed the introduction of R&D tax credits and is keen to work with government on the implementation of the DTI Innovation Review. It will be important to develop further initiatives to encourage greater investment in automotive research and development.

10. The new block exemption regulations have been in place since October 2002. The new regime provides opportunities for innovation and diversity within the distribution and servicing sector. Vehicle manufacturers are committed to delivering choice, quality and value for money for consumers. There are some concerns that the new regime is reducing choice in rural areas and that consolidation amongst dealer groups may not produce the results envisaged by the European Commission.

An Overview of the UK Automotive Sector

11. Britain is the manufacturing base for 13 of the world's leading volume car brands, has nine commercial vehicle plants, is home to 17 of the world's top 20 Tier 1 component suppliers and is the base for 20 of the world's leading automotive design engineering firms. Motor sport and specialist vehicles are "niche" markets in which the UK is a world leader.

Vehicle manufacturing

12. The most productive car plant in Europe is Nissan's Sunderland plant with Toyota's Burnaston facility in Derbyshire, Honda's Swindon location and Peugeot's Ryton plant all in the top half of Europe's automotive sites.[6] Ford Motor Company has announced in recent weeks, that the Jaguar facility at Halewood in Merseyside is their most productive site in the world. There have been investments made at the manufacturing facilities at Vauxhall, Jaguar, Land Rover, Bentley, BMW and Nissan amongst others. The UK also boasts the most productive commercial vehicle plant—the Leyland factory in Lancashire.

13. The automotive industry is an important part of the UK economy and is the second largest market in Europe, behind Germany. The automotive manufacturing sector contributes around 1.1% of GDP, with around £9 billion of added value, and represents 6.1% of UK manufacturing. More than half the products made by UK automotive companies are exported—making it Britain's biggest manufacturing exporter.

14. In 2003, UK production output rose 1.7% to 1,657,558 million units. The SMMT forecast for 2004 and 2005 is for 1.65 million units in both years. This is supported by recent investment bringing new vehicle models to be produced at UK manufacturing sites.

15. The UK new car market rose to a record 2,579,050 units in 2003—a 0.6% increase on last year's previous high. The market substantially bettered expectations, thanks to a strong and stable economic backdrop, especially amongst private buyers. This annual growth marks the third successive record market and the 11th time volumes have risen in the past 12 years. Almost a million additional units have been added to the market during this period.

16. The UK is now firmly established as Europe's second largest market, and once again out-performed Europe as a whole. In 2003 the EU market as a whole dropped below 14 million units for the first time since 1997. Of all the EU markets, only the UK and Spain saw increases in market size in 2003. The UK's share of the European market rose to 18.6%, up from 18.3% in 2002.

17. UK registrations are expected to be tempered by the expected pick-up in interest rates, which are likely to lead to a cooling in consumer spending. It is forecast that 2.5 million new cars will be registered in 2004 with 2.45 million in 2005.

[6] www.wmrc.com/press—release/20030708-1.pdf

Commercial Vehicles

18. The UK commercial vehicle (CV) business includes some 40 vehicle makers supplying vans and trucks and trailers. These businesses are complemented by a wide range of often very small companies producing bodywork for those vehicles.

19. Trucks are built as chassis cabs and need specialist bodywork or a trailer to carry a payload. No truck makers also make trailers. Over 20 companies of varying sizes make commercial trailers here and over 1,000 companies produce CV bodywork. Some trailer makers body their own chassis and some sell chassis to bodybuilders which sell completed trailers under their own brand.

20. Supporting the nine commercial vehicle manufacturers, imported vans and trucks play an important part of the UK market. Domestic trailer makers probably take over half their market and UK bodybuilders take over 80% of their market.

Engine manufacturing

21. The UK is a significant location for engine assembly in Western Europe. In volume terms car engine manufacture is the most important, with GM, Ford, Toyota, Honda, BMW, Nissan, MG Rover all having a significant presence in the market. There are also specialist companies like TVR, Cosworth and Lotus and well-established manufacturers of engines for off-highway, non-automotive and heavy commercial vehicle applications like Cummins, Perkins, Lister-Petter and Alstom.

22. The continuity of assembly at these sites and planned major developments by Ford and BMW will continue to secure the UK's future as a major force in engine manufacture and development to 2005 and beyond. In 1995 it is estimated that the UK produced about 2.1 million car engines. Currently, that total could be in the region of 2.3 million and by 2005, if the business context remains favourable, that could rise to 3.5 million. The expansion envisaged by Ford at Dagenham is a key driver and could see it directly and indirectly responsible for well over half of this total potential for car engine assembly.

23. This investment and forecast volume increases provides an important opportunity for the UK to become the global centre for engine development and manufacture.

Supply Chain

24. In the automotive supply chain, there are estimated to be 7,000 manufacturing sites operating in the UK. SMMT research suggests that there are approximately 2,000 companies where the majority of their business is in the automotive sector. It is estimated that these companies provide some 140,000 jobs and had a combined turnover of £12 billion. About 50% of these companies fall into the Small and Medium-sized Enterprise (SME) category.

25. There are also companies who supply products such as rubber, plastics, tyres, electronic and electrical components, prefabricated metal products into the automotive industry. SMMT estimates that these companies have an automotive turnover of £3 billion and employ up to 50,000 people.

26. Office of National Statistics data indicates that there has been a significant reduction in the number of enterprises operating in this market, but that total employment has remained stable.

27. In February 2003, SMMT produced a report into the automotive components sector. "Strengthening the Supply Chain" outlines the sector and sets out a range of factors affecting SMMT members. The report is included as Appendix A of our submission.[7]

Competitiveness in a stable economy

28. The high value of the pound has been a challenge for vehicle exporters in recent years. However, the weakening of sterling against the Euro has provided opportunities for manufacturers to enhance their competitive advantage. In 2003, UK vehicle manufacturers produced 69.2% for the export market. Nearly 80% of those exports were within the Euro zone. The strength of the pound against the US Dollar, however, has caused some concern to those manufacturers who export to the US market.

29. One of the key issues of the economy and competitiveness of UK manufacturers continues to be the uncertainty of future market movements. Whilst currency uncertainty is only one factor in investment decisions, the delay in announcing a timetable to decide on the UK's intentions of joining the Euro has not allayed some of the fears. SMMT continues to call for the earliest possible clarity on this which would enable manufacturers, as part of global enterprises, to secure continued investment in the UK.

30. The UK automotive industry has, for many years, been instrumental in helping itself to improve its processes and the subsequent competitiveness. The formation of SMMT Industry Forum in 1996 saw the start of collaboration between the major players in the industry, with world experts in manufacturing process improvement and acknowledged practitioners in this subject.

[7] Not printed. "Strengthening the Supply Chain" is also available at: www.smmt.co.uk/industryissues/competitiveness

31. Since 1996, SMMT Industry Forum has worked with over 450 vehicle and components manufacturers to improve performance, equip engineers with the tools and techniques of modern practices, and to train engineers from a number of other sectors. The programmes offered are practical, shop floor based process improvement activities bringing about tangible, sustainable bottom-line results. In effect, they are the industry's own dedicated resource for process improvement.

32. The linkage between skills, productivity, competitiveness and profitability is crucial to our achieving the objective of prosperity for all. SMMT Industry Forum is now working very closely with the SEMTA, the sector skills council, to ensure that a robust qualification system, capable of achieving upskilling in the tools and techniques of improving productivity and competitiveness, is developed. To this end the Learning & Skills Council has engaged IF to train a small number of NVQ Assessors throughout England to ensure their confidence and competence to deliver a consistent standard of assessment. This programme of work will feature strongly in the Sector Skills Agreement which SEMTA will submit on behalf of the Automotive Industry later this year.

Attracting and promoting inward investment

33. The automotive industry is a truly global business, and is intensively competitive. Historical national loyalties have been replaced by company values whereby operations are based wherever the greatest competitive gain can be achieved. Therefore measures which impinge on UK competitiveness have immediate effects on the prospects of UK based operations and the likelihood of attracting further investment.

34. It is essential that the UK Government plays a more active role in promoting the UK to the global automotive industry. In recent years, both the Prime Minister and the Secretary of State for Trade and Industry have given high profile support for the sector. A continued high profile by ministers and civil servants will help to reinforce government's efforts to encourage automotive investment in the UK. The Sunday Times Motor Show Live provides a welcome opportunity for Government to support the UK automotive sector.

35. The industry was pleased to see Government recognising the importance of manufacturing when it published its Manufacturing Strategy setting out the key factors guiding its approach. This Strategy supported the earlier report and recommendations of the Automotive Innovation and Growth Team (AIGT).[8]

36. The AIGT was the first of a series of innovation and growth teams established by the DTI. The AIGT drew on the expertise of all major stakeholders to identify the key issues shaping the future of the industry and how the UK can best respond to the competitive challenges which it will face.

Industry Concerns

Regulation

37. The motor industry has implemented a range of regulation in recent years, covering final product, manufacturing processes, marketing and sales as well as business regulation. The majority of it has originated at a European level and then been implemented by UK Government. The regulatory burden borne by a sector should be proportionate and fair. SMMT feels that there are instances where the UK automotive industry is more strongly regulated than other Member States and this is concerning. The industry would like to see independent impact assessments undertaken on all new EU regulation before it is progressed and the EU Competitiveness Council given a more direct role in scrutinising the economic impact of all proposals.

38. As implied above, the range of regulatory measures and other standards that the motor industry must comply with is increasingly diverse. Steps to develop cleaner and more efficient vehicles in order to reduce emissions levels and improve air quality are being taken alongside safety improvements in vehicles which increase the vehicle's weight and consequently, its fuel consumption.

39. SMMT welcomes both the establishment of the Better Regulation Taskforce and Government's recently published Revised Regulatory Reform Action Plan as positive signals of Government's commitment to providing a good business environment here in the UK. The motor industry has experience of being affected by over-complicated regulation in past, for example, on the issue of the End of Life Vehicles Directive. Industry hopes to see continued evidence of this commitment to regulating with a "light-touch". Industry representatives and civil servants from across government regularly meet to review forthcoming European legislation. These regular meetings, as well as better cross governmental awareness of the sector, have started to deliver a "no surprise" culture.

[8] AIGT information can be found at: www.autoindustry.co.uk/automotive—unit/aigt/

40. SMMT would like to highlight the problems of early implementation, over-zealous implementation and "gold-plating" of EU legislation here in the UK. In terms of early implementation, the Solvent Emissions Directive is to be implemented well ahead of the deadline laid down by EU rules thereby potentially putting the UK at a competitive disadvantage in the interim period.

41. The UK's National Allocation Plan for the EU Emissions Trading Scheme will seek emissions reduction levels in excess of that demanded by the UK's Kyoto commitment. While the commitment to addressing climate change is admirable, the effect of this decision on the competitiveness, especially of the UK manufacturing sector, is concerning.

42. There is a need for the European Commission and the UK Government to be more vigilant in ensuring a more uniform implementation of EU legislation so that UK businesses are not disadvantaged as a result of incomplete or non-implementation in other Member States.

43. As the EU expands later this year, its decision-making is set to become more protracted. SMMT feels therefore, that the extension of voluntary codes and agreements as an alternative to regulation should be supported by UK Government as a way of allowing businesses more flexibility while at the same time achieving changes more speedily.

44. SMMT is pleased to see the formation of a new European de-regulation initiative. It is suggested that cutting red tape in Europe could raise EU output by as much as 7%, and increase productivity by up to 3%.[9] Involvement by industry in the deregulation process, as well as in the formation of new regulation, is vital if the competitive benefits are to be achieved.

Skills and Training

45. The automotive industry takes skills, training and workforce development extremely seriously. While the industry itself is taking steps to address this matter, government support and initiatives are also valuable and necessary.

46. SMMT member companies report difficulties in filling vacancies due to a lack of suitably qualified candidates. These shortages include engineering graduates and technician grade candidates. SMMT feels that reforms to the UK system of higher education should not result in young people being deterred from pursuing longer and potentially more expensive courses, such as science and engineering. More vocational elements in the curriculum such as the incorporation of work experience placements would be supported. The outcomes of the Tomlinson review into 14–19 education may go some way in addressing these concerns at school level.

47. SMMT welcomes the formation of Employer Training Pilots and hopes that nationwide extension will be achieved as soon as possible so that businesses and employees in all areas can benefit from this valuable scheme. Instilling a culture of lifelong learning is essential for the long term health of the UK economy and is particularly important for a sector such as automotive, in which technologies and processes are constantly being updated.

48. The Sunday Times Motor Show Live will feature a Career's Day to present the full range of careers that the industry has to offer. The target audience for these activities will also include those who advise young people on careers. SMMT is inviting Connexions advisors and schools careers staff to the Show to see the modern industry for themselves. SMMT feels strongly that the perception of the manufacturing sector is often inaccurate and hopes that careers activities at Motor Show Live will go some way to amending these perceptions.

Automotive Academy

49. The newly formed Automotive Academy is a positive example of industry working alongside government to enhance the skills base of the sector.

50. One of the direct recommendations of the Automotive Innovation and Growth Team, the Automotive Academy is a unique organisation designed to enhance the skills of Britain's motor industry, its productivity and competitiveness. The Academy will develop a national approach to training in the industry and to kite-mark approved courses, providers and assessors.

51. The Academy has been created with the backing of £15 million of Government funds. It operates from a central administrative hub at the Birmingham Business Park, with delivery spokes being formed in Scotland, Wales, Northern Ireland and the nine English regions. The first of the regional spokes in the West Midlands and the North East have begun operations.

52. The Academy will promote skills improvements at all levels, from shop floor, right through to the boardroom, encompassing technical, leadership, management and support programmes. It will review training needs with the industry before examining existing training material which it will then either endorse or suggest modifications.

[9] "When leaner isn't meaner: Measuring Benefits and Spillovers of Greater Competition in Europe", IMF, 2003.

Research and Development

53. R&D levels in the UK are still worryingly low. Gross domestic expenditure on R&D in the UK is below that of our main competitors and has not risen in recent years. European figures show that R&D expenditure in the UK has been declining since 1994. Expenditure for 2002 was 1.84% of GDP, compared with an estimated figure of 1.99% for the EU 15 average and 2.67% for the United States. Currently the US spends 1.5% of GDP on research in contrast to the 0.76% predicted to be spent by the EU of 25 following enlargement.

54. The Pre Budget Report contained a number of examples of the kind of measures that the motor industry would like to see more of in order to support and stimulate R&D. These include R&D tax credits which will exempt diesel fuel when used in research applications and the Alternative Fuels Framework which gives more long-term certainty to companies investing in future fuels research. The new draft definition of R&D and the extension of the SME qualifying thresholds were also welcomed.

55. The industry has developed extensive working relationships with UK academia to enhance R&D levels. The recent report into the links between UK business and academia (Lambert Review) and the DTI's Innovation Review all bring forward the need for us to further the good work the industry is already participating in. SMMT is keen to work with government on the implementation of the Innovation Review.

Centres of Excellence

56. The AIGT report recommended that two Centres for Automotive Excellence be established to develop research and development on low carbon and fuel cell technologies and on transport telematics and technologies for sustainable mobility.

57. The Centre for Low Carbon Technologies is a priority issue for the Low Carbon Vehicle Partnership (LowCVP) who are advising on the implementation process and engaging industry with the outputs. The LowCVP R&D Working Group has been developing the business case and a functional specification for the Centre.

58. The Centre of Excellence on Transport Telematics and Technologies is being shaped by a core group of stakeholders. It will be a strategic ITS resource at the heart of the UK's effort to ensure that the automotive industry is globally competitive, to ensure that the UK supply base is globally competitive and to support sustainable mobility.

59. The Centres will identify gaps in existing knowledge and practice, establish integrated solutions, demonstrate how existing technology and knowledge can be industrialised, identify and bring in new players, and become leading knowledge transfer bodies for the automotive and supply base industries.

Foresight Vehicle Programme

60. Foresight Vehicle is a UK Government initiative set up to identify and fund appropriate research projects and through collaboration projects between academia and industry, develop and demonstrate appropriate product and process technologies for use in road transport for the future. Launched in 1995, the programme has involved nearly 100 projects, of which 35 are still live. Over 400 participating organisations have been involved, with the total value spent on the programme approaching £100 million.

61. Over £40 million of Government funding has already been made available with industry contributing the remainder to a total of approximately £100 million. Foresight Vehicle is currently investigating ways of securing new innovation funding through the DTI.

62. In 2003, SMMT took over the management of the programme which was formerly carried out by the National Engineering Laboratory (N E L).

63. In 2002, Foresight produced a Technology Roadmap[10] in order to identify technology and research themes for road transport, with the aim of supporting UK industry in the globally competitive market for transport products and to provide sustainable mobility for UK citizens.

Regional Government

64. The English regions are helping to attract overseas investment and supporting those incoming companies, and SMMT is pleased that they are now better funded. However, there is a need for more central co-ordination of activities. The current lack of coordination is leading to duplication of effort by officials in different regions and industry, and causes different regions to be in direct competition for automotive investment. The competition is between the UK and other countries not between different regions. There should be a more targeted approach with RDAs working within a broader national inward investment strategy.

[10] Foresight Vehicle Technology Road Map: www.foresightvehicle.org.uk/info_/FV/init01_trm.pdf

65. Productivity improvement efforts need to be nationally coordinated even though they are subsequently implemented regionally. An example of positive coordination within the regions can be seen through the North East Productivity Alliance which has seen the RDA, Government Office, universities and industry collaborating in a unique programme focussing on people and skills, new technologies and best practice dissemination. These activities need to be replicated nationally to ensure that duplication of effort is reduced.

Access to Support Programmes

66. The automotive industry in the UK has benefited from a wide range of support from the government. Automotive manufacturers throughout the industry have taken advantage of European selective assistance support down to local levels of support offered by Business Links, Learning and Skills Councils and respective Regional Development Agencies. In between these two extreme levels, the industry has benefited from financial and non-financial support offered by central government.

67. The various governmental institutions all offer a wide range of business support programmes. The experience of those in the automotive sector suggests that these can be difficult to access and information on the full scope of the services offered is difficult to find. Multiple qualification criteria, different access arrangements, a lack of easily available guidance and knowledgeable staff administering the schemes also present significant barriers to the take-up of schemes. A single entry point that would provide expert advice and guidance for automotive companies would help to maximise the benefits of these schemes.

Trade Concerns

68. As a global business, the automotive industry favours trade facilitation measures. However, in relation to the World Trade Organisation (WTO), reductions in customs tariffs must be matched by the elimination of non-trade barriers (quotas, local testing and certification regulations, limiting distribution channels etc) if the competitive edge is to be maintained.

69. The industry has called for an elimination of "nuisance" tariffs (below 2%) on components which currently create added bureaucracy for members, often outweighing the perceived outcomes of the programme.

70. The industry is supportive of global free trade, but there is increasing concern that the WTO negotiations fail to deliver trade liberalisation which would help global manufacturing companies. The "big conference approach" has become a target for protest groups and political posturing, whereas bilateral agreements (such as that between the EU and Mexico) deliver fast, efficient results to the benefit of the industry.

71. SMMT member companies feel that the WTO dispute settlement process is slow and costly. Members have had to spend considerable resources building cases, without any certainty that the issue will ever be settled.

72. In encouraging overseas investment in the UK, SMMT and its members have welcomed the new sectoral approach adopted by UK Trade & Investment. This is a step forward that has benefited the industry and helps to ease some cross-governmental issues. There is a need for the new sectoral teams to be staffed at a senior level in order to give the new structure suitable credibility when dealing with government postings. There must also be a renewed focus on supporting medium to large sized firms as well as SMEs and new exporters.

Uncertainty in Alternative Fuels Support

73. The recent uncertainty created by the exhaustion of grant funding for TransportEnergy programmes, which provides purchase incentives for cleaner vehicles and technologies, has caused considerable concern. It is essential that these well supported programmes are adequately funded and that they prioritise the cleanest and most environmentally beneficial technologies. The Society hopes that government moves quickly to provide greater certainty for consumers, fleet managers and manufacturers. In particular the programmes should be based on clear environmental criteria and be available to all qualifying technologies.

Accessibility Regulations for Bus and Coach Manufacturers

74. The Public Service Vehicles Accessibility Regulations 2000 set target dates in 2014 and 2016, after which all buses used on local services have to be wheelchair accessible. Under the current system, operators buy new vehicles when they can make a commercial case for doing so, not according to a pre-determined replacement rate. This results in peaks and troughs in purchases.

75. On the "straight line" replacement basis, which SMMT has to use as its basic model, purchases of new buses are already being identified as insufficient to allow the accessibility deadlines to be met. Manufacturers and importers alike predict a purchasing peak from around 2011 and are concerned that there will be insufficient capacity to allow demand to be met. Government action or guidance to encourage a more consistent investment by operators and/or for manufacturers is needed if vehicles to make these regulations successful are to be available.

76. The Department for Transport have indicated their intention to apply accessibility regulations to coaches used on touring and leisure services (as opposed to the National Express or "Oxford Tube"-type services). Discussions are at a very early stage, but manufacturers have already highlighted concerns about the effects on vehicle design and, hence, on the acceptability of vehicles. Members have expressed very strong concern that accessibility requirements for smaller coaches (less than 22 seats) have implications for the UK manufacturer of such vehicles.

Digital Tachographs

77. Bus, coach and commercial vehicle manufacturers are very concerned about the introduction of digital tachographs. There is a severe concern that the legislation is still due to be implemented in 5 August 2004 despite the lack of compliant equipment which will enable users and manufacturers to incorporate the technology into product lines. This is an example of technical legislation that was passed without the full involvement of industry at the earliest stages of discussion. SMMT has urged government to push for a delay in the implementation of this legislation to allow suitable technology to be identified.

78. Delays in the introduction of a UK scheme for national type approval of buses and coaches are hindering the industry's ability to adapt its procedures to the needs of the EU Whole Vehicle Type Approval system. Progress on the UK scheme is imperative in SMMT's view.

Vehicle Sales, Distribution, Servicing and Customer Support

79. Vehicle manufacturers operating in the UK market are clearly focused on delivering choice, quality and value for money to consumers. There have been a number of significant developments during the last few years and these will continue to influence competition, service and value into the future.

Block Exemption Regulation

80. Supply, distribution and servicing agreements within the car industry have benefited from a block exemption from EU competition rules since 1985. The European Commission agreed on new rules to reform the Motor Vehicle Block Exemption in July 2002, but with a one year transition period to allow the industry to implement the necessary changes. The new regulation "Distribution and Servicing of Motor Vehicles in the European Union" came into force on 1 October 2002. The European Commission claimed that the revised regulation was designed to open up the sales and repairs of cars to increased competition and reduce restrictions imposed on dealers and repairers.

81. The Block Exemption Regulation is now a permissive, rather than a proscriptive, piece of legislation, allowing companies that operate in the franchised and independent sectors of the market, greater opportunities to identify and exploit new developments.

82. In the CV market, multi-franchise dealers, handling and both sales and after-sales service, has meant that the Block Exemption changes have done little more than codify existing custom and practice in UK commercial vehicle sales, distribution and aftermarket arrangements.

83. Since the introduction of the new regulations, the industry has become aware that small retail dealers offering service and choice for rural customers are leaving the industry. We are also beginning to see potential consolidation of large dealers which could also reduce choice for customers within regions. Such points were all raised by SMMT during negations with the European Commission.

Car Pricing

84. According to Office of National Statistics data the price of new cars fell by 2.9% in 2000, by 4.4% in 2001 and by 0.8% in 2002. In 2003 they reported a 0.8% increase in prices, the first rise since 1998. There are a variety of other sources of car price information all confirming the significant year-on-year reductions in car prices since the late 1990s.

85. The European Commission prepares a twice yearly report comparing vehicle prices in different EU member states. The most recent highlighted the gradual harmonisation of European car prices, but also the considerable differences that existed between some markets. The UK has now become one of the cheaper markets in Europe, which reflects the substantial change in the Euro/Sterling exchange rate.

SMMT New Car Code

86. The OFT has established a Consumer Codes Approval Scheme to promote consumer codes of practice that meet demanding core criteria. These are aimed at safeguarding the interests of consumers and cover the organisation of the code sponsor, the preparation and content of the code, complaints handling, monitoring, compliance and publicity.

87. SMMT is close to finalising OFT approval for its New Car Code. This sets out standards that all manufacturers will comply with regarding new car sales; the terms and operation of car manufacturer warranties, the availability of replacement parts, repairs and servicing, advertising and complaints handling.

88. The SMMT has operated a consumer code of practice since 1976. This had been jointly operated by SMMT, the Retail Motor Industry Federation (RMI) and the Scottish Motor Agents Association (SMTA). The new OFT approval scheme requires a more rigorous approach to compliance, which includes regular monitoring and appropriate penalties for those that consistently fail to deliver on the code's promises to consumers.

Repair and Service

89. In August 2000 the OFT published a report into car servicing and repair. This recommended the setting up of a taskforce to address concerns about the quality and reliability of the services offered by franchised and independent garages. In September 2001 the DTI published the task force's report, which focused on the establishment of a voluntary code of practice and led to the publication of guidance for consumers.

90. In 2003 the Retail Motor Industry Federation, with support from the DTI, vehicle manufacturers and other motor industry trade bodies, announced their intention to launch a revised and strengthened code of practice for all companies involved in the service and repair of motor vehicles. The scheme, "CarWise", is due to be formally launched with OFT approval later this year.

New Car Warranties

91. In July 2003 the OFT launched a study into warranties for new cars. The study focussed on how competition in car servicing was affected by restrictions on where cars could be serviced during the warranty term. In December 2003 they published a report recommending that manufacturers and dealers should improve the advice provided to consumers on their options for servicing new and nearly-new cars and their statutory rights. In addition manufacturers and dealers were asked to remove servicing restrictions from their new car warranties.

92. In response vehicle manufacturers have provided assurance to the OFT that those operating restrictions will remove them. The information on warranties contained in the SMMT New Car Code will be made widely available to consumers.

93. The sales, servicing and repair of motor vehicles have been the subject of significant scrutiny and analysis by the Government and competition authorities in recent years. The industry has responded positively to all the concerns that have been raised and sought to demonstrate their commitment to delivering value for money to consumers.

February 2004

APPENDIX 11

Supplementary memorandum by the Society of Motor Manufacturers and Traders Limited

When SMMT gave evidence to the Trade and Industry Committee it was indicated that further input on areas where Government could improve its support for the automotive sector would be welcome. In its evidence SMMT highlighted the impact of regulation, the need to do more to encourage investment in R&D and for Government to do more to promote the UK to global automotive companies. We believe there are some specific actions that could be taken to make progress in these areas.

Regulation

The automotive industry is one of the key contributors to UK and European competitiveness. However, the current economic environment is particularly challenging and there is a strong need to promote a better regulatory environment. This was the main focus of a recent meeting between the European Automobile Manufacturers Association (ACEA) and the President of the European Commission, Romano Prodi.

SMMT would urge the UK Government to increase pressure on the European Commission to conduct more rigorous and independent assessments of the impact of regulatory changes at the earliest stages of their development. This should specifically examine any impact on competitiveness and should be linked to a stronger and more formal scrutiny role for the Competitiveness Council.

The DTI Automotive Unit leads a cross-departmental initiative to identify areas where new or enhanced regulations are being developed by the European Commission and UK Government that impact on our sector. This approach needs to become embedded and systemised within the culture of government officials so that there is greater transparency in the policy making process. It should be the norm for Government to have discussed the aims and objectives of new initiatives with industry, before supporting the development of proposals in European level working groups.

Support for R&D

The future success of UK manufacturing, particularly amongst companies in the automotive supply chain, will depend on their ability to develop new products and innovative solutions for global vehicle manufacturers. The key to lifting R&D spending in the private sector lies not only in carefully targeted financial and fiscal policy measures, but in adopting "holistic" measures spanning areas as diverse as education, public procurement and competition.

It is essential that there is a sustained increase in R&D expenditure. SMMT would like to ensure that the two centres of excellence recommended by the Automotive Innovation and Growth Team are up and running as soon as possible. The Foresight Vehicle Programme has been very successful and it is important that this valuable programme continues to be adequately funded.

Major sources of funding for R&D are the European framework programmes, but UK companies have not tended to fare well in accessing these funds. This is because of the complex and time-consuming process involved and the requirement of a good understanding of how the system works. Foresight Vehicle is working with the DTI and the Framework 6 National Contact Point for Sustainable Surface Transport to examine ways to help companies, particularly the smaller ones, and guide them through these processes.

The Government has put in place a number of programmes to support R&D and demonstration projects, it has also introduced R&D tax credits. Despite this there is still a relatively low level of awareness of what is available and how to access it. The DTI should develop, with SMMT and Foresight Vehicle, a strategy to increase awareness and provide advice and support for automotive companies so that they can maximise the benefit of these existing schemes.

Promoting UK Automotive

UK ministers need to recognise that they can have a very significant influence on investment decisions by engaging directly with the senior figures in the global automotive industry, especially the UK representatives of those large investors. The involvement and support of ministers for automotive events and activities provides a clear signal to the sector of the Government's commitment. The more that can be done to raise the profile of the sector the easier it will be to attract new investment. The British International Motor Show at the NEC provides an ideal opportunity for ministers to demonstrate their support and commitment to the sector. SMMT would hope that the Trade and Industry Committee would endorse the view that senior members of the UK Government should attend.

Euro Pricing

SMMT is aware that an issue about the purchasing practices of vehicle manufacturers was raised by the Committee by other witnesses. The Society understands that some vehicle manufacturers require suppliers to invoice in Euros and others allow them to choose either sterling or Euros. Policies adopted will vary from company to company and depend on its own currency and risk strategies.

Christopher Macgowan
Chief Executive

15 March 2004

APPENDIX 12

Memorandum by Toyota

1. Background

1.1 Toyota is the world's third largest automobile manufacturer, producing over six million vehicles each year—equivalent to one every six seconds. Toyota vehicles are manufactured in 58 plants in 27 countries and marketed in over 160 countries.

1.2 Toyota's philosophy has always been to produce the right car at the right place at the right time and so contribute to the societies in which we operate. This policy of "localisation" means that R&D, design, manufacturing and sales are established as close as practical to various global markets. To meet the increasing demand for Toyota vehicles in Europe, Toyota has gradually been expanding its presence within the market. Starting with the UK at Burnaston in 1992, Toyota now also produces vehicles in France and Turkey and has a joint venture with PSA Peugeot Citroen in the Czech Republic which is due to commence production in 2005. In addition, we have engine plants in Deeside and Poland as well as a separate transmission plant in Poland.

1.3 Toyota's UK manufacturing operations are the responsibility of Toyota Motor Manufacturing (UK) Ltd (TMUK). To date over £1.7 billion has been invested into the UK car and engine manufacturing facilities in Burnaston and Deeside. Burnaston produces two models; the Corolla and the Avensis. The Avensis is exclusively produced here in the UK. Production levels for 2003 were 213,500 vehicles, up on expectations, and 400,000 engines and CKD parts. Since start of production in 1992 TMUK has built over 1.5 million vehicles and over 1.5 million engines. 80% of vehicles produced in the UK are exported, predominantly to the rest of Europe, adding some £460 million to the UK's balance of payments. In 2003, the Avensis became the first European produced Toyota vehicle to be exported to Japan where it is on sale nationwide.

1.4 Toyota (GB) PLC is the importer and distributor for Toyota and Lexus vehicles in the UK and is responsible for sales, marketing, after-sales and customer satisfaction. Sales are managed by a network of around 200 Toyota retail centres and 50 dedicated Lexus centres. We offer the UK's widest product range comprising 14 different Toyota vehicles as well as six Lexus models. Around 133,500 of our vehicles were sold in the UK in 2003 giving a market share of 4.6%.

1.5 Toyota has a philosophy of being a good corporate citizen wherever in the world we operate. It is a responsibility we take very seriously as we recognise the benefits such assistance can make to organisations and to people's lives. Given the nature of our business we tend to focus our support on issues relating to the environment and safety especially where children are concerned. Over the past year in the UK this policy has resulted in support for initiatives organised by the British Red Cross, The Children's Trust and a variety of local community projects.

1.6 Toyota's commitment to the UK is therefore very strong but this must be sustainable. As a global business Toyota in the UK needs to be able to compete with businesses across the euro zone (including new entrants). The perceived advantages of investing in the UK have gradually eroded impacting upon our competitiveness and we believe this is due to three key elements:

(1) Macro economic factors notably the fluctuations of exchange rates plus government intervention in the UK market.

(2) Lack of policy consistency or a holistic approach to the sector.

(3) Diminishing skills and supplier base in the UK.

This submission focuses upon the impact of these factors upon Toyota's ability to do business in the UK but also looks at the ways Toyota is adapting and investing in future technology.

2. Macro Economic Factors and Government Intervention

2.1 By the end of 2003, Toyota had enjoyed 11 consecutive years of growth in terms of sales in the UK. This remarkable run of success has contrasted with the fortunes of our manufacturing operations. Despite increasing demand and an operation which is one of the most efficient in Europe, the company has faced considerable challenges and has lost a cumulative £722m since production started in 1992.

2.2 Toyota chose to establish itself in the UK for a number of reasons notably the UK's long tradition of engineering and vehicle manufacturing; experienced supplier base; skilled work force and a good communications infrastructure. However many of these attributes have been eroded. At the same time the cumulative impact of regulation from the UK and European institutions has impacted upon our business plus we have suffered due to the historic strength of Sterling against other European currencies, most obviously, the Euro.

2.3 In the last two financial years for which accounts have been filed, TMUK has lost a cumulative £270 million. To counteract difficult operating conditions, Toyota has instigated a series of measures. These have been described as a "survival plan" and include:

- Removing cost from the operation—a target of 30% reduction in overheads has been set and largely accomplished. This has not been achieved by "squeezing suppliers" as such a tactic invariably means a drop in quality. Instead, we have been taking costs out of operations, improving efficiency and working with suppliers to improve their productivity and quality. Indeed, Toyota has long worked with its suppliers to ensure the quality standards are met. This philosophy has been taken up by the Industry Forum and we remain very supportive of this Industry/Government initiative.
- Requiring suppliers to invoice in Euros—this has helped us offset some of the exposure to the Euro and—in combination with other measures—negated the need to hedge against currency fluctuations. It should be stressed, however, that this measure does not totally remove our exposure and, given the increasingly multi-national nature of the supply base in the UK, has been a move which our suppliers have been happy to meet.
- Improving production processes—The essence of the Toyota Production System (TPS) is "kaizen" or continuous improvement. This is ingrained in all our members. The onus is on them to identify ways in which the system can be improved still further—not by additional investment but by improving process. This has—and will continue to deliver—improvement in the operational efficiency of TMUK.
- A more favourable exchange rate—the recent increase in the value of the Euro versus Sterling has helped, given that 80% of our vehicles are exported to Europe. Although not at the optimum level for exporters (somewhere around 1.38 Euros to the pound) its increase in value has helped.

2.4 However, the "survival plan" invariably focuses on maximising the utilisation of fixed assets and therefore reducing fixed costs per vehicle. In May 2003, we announced our intention to move to a three-shift pattern at the Burnaston plant in 2004 (Deeside already operates on three shifts) and we are confident we will do so. This will have a significant and positive impact upon employment and production at Burnaston. We are currently putting in place the necessary preparations. This is a considerable logistical exercise, the complexity of which should not be underestimated. For the UK, TMUK's move to three shifts has a number of benefits; first, the increased production will largely be exported adding further to Toyota's contribution to the UK's balance of payments; secondly, this increased production will have "multiplier effects" boosting the supply industry, the local economy and, finally, will create up to 1,000 additional jobs at TMUK alone.

2.5 Toyota currently employs over 5,500 people directly in the UK and many more when one adds in the jobs created at retail centres, suppliers, and other related industries. Despite the challenging economic conditions we have maintained our commitment to our staff or "members". The relationship between members and management is one of the strengths of the "Toyota Production System". Through the Toyota Management Advisory Board (TMAB) process we have a robust forum in which issues such as the Annual Salary review can be discussed and actions agreed which will be supported by all members.

2.6 Our track record on industrial relations is excellent and is a tribute to the process and the good working relationship with our members and the Amicus Union. Our members have shown exceptional flexibility over the past two years as we have had two model changes in quick succession. This places enormous strain on management and members alike but has been achieved whilst actually raising levels of quality. Having to recruit up to 1,000 new members could have caused difficulties but our experience is that we remain an attractive employer in the region and beyond.

2.7 Our attractiveness as an employer is, we believe, because we offer a commitment to our members. We continue to offer a final salary pension (for those who stay with the company over five years). This we believe is a tangible benefit that we are keen to maintain. However, we have some concerns over the proposed Pensions Protection Fund. Whilst we applaud its objectives and the need to safeguard final salary pensioners whose employers have gone out of business, we would need to consider the details of the proposals as it could have the potential to undermine well-managed pension schemes in order to safeguard those who failed to invest or lacked the foresight to do so. This could act to accelerate the move away from final salary schemes.

2.8 Toyota is committed to long-term employment and therefore we aim to maintain permanent employment levels despite inevitable changes in production and model cycles. To do this, however, requires a certain degree of labour market flexibility. At Toyota in the UK we employ temporary staff, when necessary, which allows us the opportunity to react to changes in demand and model cycles. We are therefore pleased that the UK Government has opposed EU proposals to reduce qualifying time for equivalent permanent terms and conditions as this would place manufacturing in the UK at a competitive disadvantage. This issue may return and so therefore we urge the UK Government to continue to oppose these proposals.

2.9 Another key element of flexibility is the Working Time Directive opt out. Although used sparingly, we firmly believe that this should remain optional for all employees. However this option is essential for us in order to maintain our commitment to our permanent members throughout variations of model and production cycles. TMUK exemplified as best practice in a recent CBI study urges the UK Government to oppose any abolition of the UK opt out.

2.10 However we find that our prudent and responsible approach has not been matched across the sector. We do not believe that it is fair or competitive for companies that do not take measures to adapt to economic changes to be supported by government grants. Government grants to individual operators of significant sums undermine fairness and Government commitment to competitiveness and the "level playing field" for all operators. We therefore welcome the overall findings of the Public Accounts Committee that recently suggested that Regional Selective Assistance (RSA) grants were not achieving the benefits expected and instead having some negative effects. Toyota did not choose to invest in the UK because of government enticement and we continue to invest without such financial support. We therefore argue that the success of the UK automotive sector depends not on government subsidy but on the maintenance of competition against which the best will flourish.

3. Policy Consistency and Holistic Approach

3.1 Toyota takes great pride in its responsibilities as a corporate citizen and as such we recognise the importance of operating at the highest possible standards for the benefit of our members and the wider community. However the difficult economic climate has been made more problematic by an increasing regulatory and fiscal burden including Climate Change Levy and other environmental regulations which we estimate could cost £3–5 million annually.

3.2 It is not necessarily the individual impact of each piece of new regulation that is harmful to doing business in the UK but it is the cumulative and often conflicting effect of such regulation that hinders our ability to compete in a very competitive environment. By way of example the forthcoming EU Emission Trading Scheme (EU ETS) is a notable scheme to reduce CO_2 emissions from all industry but in the case of the automotive sector, its implications have not been fully thought through.

3.3 There is growing concern about this for a number on reasons. First, its early implementation. The UK government is set on meeting EU deadlines and appears to be one of very few Member States intent on doing so. This could put UK manufacturers at a significant competitive disadvantage. Due somewhat to tight timescales its application has been confused and uneven with some manufacturers apparently exempt whilst a single plant has captured 25% of the sector allocation. This contravenes the principle within the directive to prevent undue competitive disadvantages within sectors and urgently needs addressing. Second, the burden to be placed on industry for compliance would be hugely disproportionate to the benefits in CO_2 emission savings that can be achieved. A recent study in relation to the climate change levy put the savings achievable by the automotive sector at around 5% of all energy use and only 1–2% on more modern and efficient plants such as Burnaston. The EU ETS expects unrealistic improvement on gas use (19% reduction at two shifts or 27% at three shifts). It also does not take into account Best Available Technology and the ability therefore of more modern and efficient operations to improve. One of the most cost effective means of expansion is through shift pattern changes but this could be penalised under the current measures as this is specifically excluded from the New Entrant Reserve free allocation that appears to contravene the Directive definition of expansion of existing facilities. Finally, the experience of the climate change levy indicated such a trading system is very difficult to establish in such a competitive sector, one which is increasingly "footloose".

3.4 We fully accept that the most important issue facing the industry is the environment. Toyota is committed to reducing the impact of the car on society. We are striving for "zero emissions" at every stage of the vehicle's life cycle—research and development, design, production, use and disposal. In the UK Toyota's commitment to this is based on 5Rs: design refinement; waste reduction; material re-use and recycling and retrieval of energy. This approach needs to be supported, where appropriate, by consistent and holistic legislation.

3.5 Toyota's philosophy has always been to produce the right car at the right place at the right time. This applies equally to manufacturing and marketing strategies as it does for environmental development. The introduction of new technology will not be simultaneous in all markets given variable resources, infrastructure, regulatory frameworks and consumer demand. Developing the "car of the future", therefore, means developing a range of technologies.

3.6 Toyota is putting this approach into practice. Having launched the first mass produced hybrid car, the widely acclaimed Prius, in 1997, we have recently launched an all new model. The new Prius combines a conventional 1.5 litre petrol engine with a compact 500v electric motor and achieves new levels of lower emissions and fuel consumption, particularly in congested urban areas where air pollution is most crucial. At 104g/km for a D-segment car, it is arguably the cleanest car on the market.

3.7 Hybrids remain new technology and, as such, there is an understandable consumer wariness and due to higher technology and manufacturing costs, a price premium. In order to overcome these financial and market barriers and encourage the take up of new technologies, the Government has included hybrids on the Powershift register and therefore eligible for a Powershift grant. Such support is critical if consumers are to be convinced of the merits of purchasing cleaner vehicles. However the Powershift grants have been over-subscribed in the past 12 months and there is now a funding shortage. Despite assurances of the Government's commitment to cleaner vehicles, a recent consultation by the Energy Saving Trust on Powershift funding proposed grant cuts of up to 40%. This will undermine confidence in the market and could affect sales dramatically. Whilst the need for the review of funding is clear, rather than the "across the board" approach proposed, the review should direct the majority of the support towards the very cleanest vehicles whatever the technology. This would be in keeping with the objectives of the Low Carbon Vehicle Partnership, and indeed the Government's broader environmental goals.

3.8 The Powershift issue is symptomatic of the wider policy confusion over fuel technology. We welcomed the Treasury's indication in the Pre Budget Report that current financial incentives for the likes of LPG will be reduced over coming years to reflect more fairly their actual environmental benefits. We wish to see fiscal incentives being used to ensure the development and take up of the best and cleanest technology and for the assessment criteria to be regularly assessed.

3.9 The range of regulatory measures and other standards that the motor industry must comply with is increasingly diverse. For example, steps to develop cleaner and more efficient vehicles in order to reduce emissions levels and improve air quality are being taken alongside the need to adapt to the increasing regulation and consumer demand for safety which increases the vehicle's weight and consequently, its fuel consumption. The motor industry must therefore face a number of challenges simultaneously, some of which conflict.

3.10 For instance, like all vehicle manufacturers, we must reduce CO_2 emissions in order to meet our 140g/km average fleet target. However, Toyota recognises it must also improve air quality which could be worsened by the "dash for diesel" CO_2-based measures such as the Company Car Tax. Whilst diesels tend to emit less CO_2 than petrol engines, emissions of NO_x (which results in ground level ozone) and harmful particulate matter (PM) are much higher in diesels. Toyota has therefore produced a unique technology to reduce diesel emissions.

3.11 Toyota has developed D-CAT—the first diesel after-treatment catalyst to combat both NO_x and PM. D-CAT halves NO_x emissions and reduces PM by over 90% (from 0.21 to 0.005g/km). For the first time, diesels will have the potential for regulated emissions close to those of petrol without sacrificing the CO_2 benefit. To bring this technology to market in any numbers, however, the next round of European diesel emission standards (Euro V) must be much more stringent. Inevitably, other manufacturers will claim treating Nox and PM emissions will be too high a price to be commercially viable and would undermine attempts at CO_2 emission reduction. We would reject those accusations and urge the relevant Departments to introduce sensible regulations which encourage new technology. We recognise that policy should support environmental objectives but in order to do this successfully it should also encourage the development and take up of new technologies.

3.12 It is important for both the productivity and competitiveness of the UK automotive industry that policy makers in London and Brussels apply a long-term holistic approach to the sector. This involves taking a broader look at targets and their compatibility with policy objectives. It means ensuring targets are the same across the EU and it means providing sufficient lead in time to new regulations to ensure that manufacturers can adapt successfully. This is critical where industries are competing on a global scale.

4. Skills and Suppliers in the UK

4.1 At Toyota we believe in continuous development and we strive to ensure that all members achieve their full potential. The practical expression of Toyota's people and customer-oriented philosophy is known as the Toyota Production System (TPS). This is not a rigid company-imposed procedure but a set of principles that have been proven in day-to-day practice.

4.2 The foundations of TPS are built on standardisation to ensure a safe method of operation and a consistent approach to quality. The system is built around standard processes and procedures, which members learn and thereafter are encouraged to improve in order to ensure maximum quality, improve efficiency and eliminate waste. We invest considerable resources in training and ensure tailored personal development opportunities for our members throughout their employment at Toyota. We provide all members with an introductory programme explaining our philosophy and values. We then provide individual on the job plans developing skills essential to the business and we set targets in order to demonstrate competence. The aim is continually to improve the skills and competency of our members aligned to business needs. We are also planning the creation of a modern technician apprenticeship scheme leading to NVQ Level 3 to be operational by the end of 2005. Training of our members is therefore a major priority, a commitment that has been recognised in the repeated awarding of Investors in People status.

4.3 As part of the UK automotive industry we have proactively tackled the skills issue by being founding members of the Industry Forum. This Forum has increased the transferral and development of skills in the sector through practical, shop floor based processes bringing about tangible, sustainable bottom-line results.

4.4 The industry however continues to have difficulties in filling vacancies due to a lack of suitably qualified candidates. These shortages include engineering graduates and technician grade candidates. We also find that mathematics skills of applicants are particularly poor. Toyota believes that reforms to the UK system of higher education should not result in young people being deterred from pursuing longer and potentially more expensive courses, such as science and engineering. There also needs to be a more vocational element in the curriculum of some courses, such as the incorporation of work experience placements. It is vitally important that children are informed at an early stage in their career path development of the benefits of a career in industry which we believe is sadly lacking currently.

4.5 As a responsible corporate citizen Toyota has always tried to use UK based suppliers which has had a positive impact upon the local and regional economy. As we operate Just-in-time manufacturing we require efficient and reliable suppliers and once found develop long-term relations with them. However, the changing structure and location of the automotive supply sector is forcing a readjustment of the UK-overseas supply ratio. Toyota's supplier partners face a number of challenges:

— A gradual erosion of UK-produced content as Euro-zone located suppliers compete aggressively on quality and price. Current UK content is less than 50%.

— There is still a lower level of quality from European suppliers (including UK) compared with Japanese suppliers.

— Global competitiveness (notably £/€ and €/Y exchange rates as well as increased cost of raw materials) will place further cost pressure on UK suppliers.

— Japanese production levels in Europe have now reached "critical mass" which would make them more attractive to Japanese suppliers.

We are concerned that if this situation is not rectified the availability and quality of UK suppliers will continue to decline until partnership with them is no longer viable.

5. Retail Experience

5.1 In contrast to our manufacturing business the retail sector has enjoyed successive years of record sales. Toyota has still managed to outperform the market with 11 consecutive years of growth. The causes of this "boom" are perhaps due to more varied, desirable, well-made vehicles tempting consumers into the showroom but also to renewed consumer confidence and competitive pricing. The allegations of "rip off Britain" in the car sector have disappeared as prices have aligned with other Member States.

5.2 During the Competition Commission inquiry into new car process, we consistently argued that the price disparity between the UK and abroad was the result of a number of factors including specifications and, significantly, exchange rates. The increase in value of the Euro has therefore had a dramatic effect on comparative prices. This has been clearly demonstrated in the significant fall in parallel imports.

5.3 However, the Competition Commission also highlighted some flaws in the competition arrangements covered by the "Block Exemption Regulation (BER)". Toyota felt that there was indeed justification for a review of the arrangements, some of which had become outdated and against the consumer interest. Through JAMA we had a positive dialogue with the European Commission and welcomed most of the revisions to the BER.

5.4 We have adapted successfully to the Block Exemption changes in the UK. We have used the BER review as an opportunity to reassess our network, redefine standards to a higher level and thereby improve the retail experience. Retail outlets have been redesigned to create a more welcoming environment for customers—both male and female. In addition, a "hub and spoke" approach has been adopted which means that a better service offering is available to a wider number of locations. This is a significant step for Toyota and one which seems to be delivering results as customer surveys reveal positive reactions to these developments.

5.5 We have also made considerable investment in training for our centre management, sales and service personnel. In 2002 a Toyota and Lexus academy was opened at Nottingham Trent University. This 1.2 acre site provides classrooms, two showrooms, training workshop and body/paint shop designed to cater for 10,000 delegates a year. Both formal qualifications and professional development programmes are offered in conjunction with the university's respected business school and centre for Automotive Industries Management. We also recognise our role in the local community and as such have joined forces with the Prison Service to help finance a scheme that provides technician training and the possibility of obtaining a level 3 NVQ.

6. Conclusion

6.1 Toyota has invested heavily in the UK and is committed to doing business here in the long term. The exposure to exchange rates will continue to be an issue for the company although we are taking every step to minimise that exposure. For the present, however, any deterioration from the current level could have a negative effect on the company's profitability. Exchange rates, however, are not necessarily in the gift of governments. The area in which the Government should focus its efforts, therefore, is in minimising the effects of regulation and ensuring any new proposals are implemented with a "light touch." Furthermore, continuing intervention by the Government into the market place not only undermines competitiveness but sends the wrong message to overseas investors.

APPENDIX 13

Supplementary memorandum by Toyota Motor Manufacturing (UK) Ltd

Thank you for the opportunity to provide oral evidence to your inquiry into the UK Automotive Industry on the 30 March. We welcome your Committee's interest in the future of our industry and hope that our contribution was helpful to you.

During evidence you asked us to respond to you in writing on three specific issues:

(1) Implementation of the EU Emissions Trading Scheme.

(2) The Working Time Directive Opt Out.

(3) Comparative costs with non UK based Toyota manufacturing facilities.

I hope the attached note addresses these issues and answers any further questions which may have arisen since our oral evidence. On a slightly lighter note and in response to a comment made, may I assure the Committee that, whilst I may attend the Grand Prix from time to time, nothing associated with Formula One is in any way free—particularly for those companies with a participating team.

We look forward to your report and recommendations later this Spring and also to the inquiry into Emissions Trading which we hope you will be able to instigate at the earliest opportunity.

1. EU Emissions Trading Scheme (EU ETS)

We welcome your Committee's intention to hold an inquiry into the issue of Emissions Trading. We hope that such an inquiry will help clarify a number of uncertainties in the current UK ETS proposals. Whilst we welcome the objectives of the EU ETS, we remain concerned that the UK's proposals are rushed and ill-considered which will result in an inequitable and anti-competitive implementation for many UK automotive companies.

The UK is already one of the few Member States to publish its proposed National Allocation Plan (NAP). This headlong dash to "lead the way in Europe on emissions trading" could disadvantage UK companies significantly. Indeed, it is already a concern in that Rolf Annerberg, the Chief Adviser to the European Environment Commissioner Margot Wallstrom, praised the UK for being "good, rigorous, stringent and tough on its industry", whilst what few other NAPs have been submitted were "simply farcical". Our hope of a level playing field with the rest of Europe on this seems forlorn.

ETS and Climate Change Agreements

One of the most significant issues is the relationship between EU ETS and CCA and the merits or otherwise of a company "opting out" of ETS and therefore remaining with the CCA. This is an option open to us but a considered decision is virtually impossible given the fact that the UK's proposed implementation of EU ETS remains unclear and the proposed revision of the CCA targets will not take place until summer 2004—after the submission of the NAP to the EU. TMUK cannot, therefore, make a sensible decision on the opt out. We urge the Government to extend the deadline by which time all companies must decide whether they will remain with CCA or sign up to ETS, until after the CCA targets have been revised. An early inquiry by your Committee into this matter would be most advantageous.

Unrealistic targets

As expressed during oral evidence our concerns over EU ETS rest in its rushed implementation. The current government plans will result in emission reduction targets which are neither realistic nor fair across the industry. It is certainly not the "level playing field" we expect from government as can be seen from the following table.

	Kyoto	*UK EU ETS*	*SMMT EU ETS*	*SMMT CCL*	*Toyota EU ETS (2 shift)*
Start	1990	1990	2002	1995	2002
Finish	2010	2010	2005	2010	2005
% reduction	12.5	16.3	18.8	15	22.7
% Rate pa	0.6	0.8	6.3	1	7.6

The table shows that TMUK's own reduction target of 22.7% is well in excess of the Government's overall UK reduction target under ETS of 16.3%. Also TMUK's rate per annum 7.6% reduction is 12 times tougher than the Kyoto target of 0.6% and more than our SMMT competitors.

The proposals do not take into account best available techniques but demand "across the board" reductions, regardless of the nature and efficiency of the plant in question. The current plans would therefore place TMUK with its modern facilities at a significant disadvantage within the market. In fact, no technology is currently available which would enable TMUK to meet its target. This contravenes Annex III criteria 3 of the EU Emissions Directive in that the technological potential does not exist to reduce emissions to the allocated level.

Anticompetitive allocations

The current proposals benefit one or two key automotive players and put the rest of the market at a significant competitive disadvantage. One conglomerate has been given 70% of the sector's allocation for CO_2 emissions but is currently slowing down UK operations. Other key competitors seem to be excluded from this process altogether, giving them a significant cost and investment saving. Both of these issues contravene Annex III criterion 5 of the Directive.

Inhibiting investment and expansion

TMUK's proposed increase in volume would be significantly affected by the current plans. The Government has excluded such increases utilising existing facilities from the new entrant reserve (NER) allocation. This means that TMUK will have to buy allocation from competitors in order to increase volume. It is likely we will have to buy from businesses closing down operations in the UK as they will have spare allocation. This is anti-competitive and penalises companies wishing to invest further in the UK whilst benefiting those that are seeking to reduce their presence here.

TMUK has provided a written submission to DTI and Defra on EU ETS and we enclose a copy for the Committee's consideration [*not printed*].

2. Toyota France and the Working Time Directive (WTD)

Although used sparingly, we firmly believe that the WTD Opt Out should remain optional for all members. This option is essential for us in order to maintain our commitment to our permanent members throughout variations of model and production cycles. The Opt Out system at TMUK is purely voluntary and must be justified and then personally approved by TMUK top management each time. All hours are monitored closely and action taken should the number become a concern. We have done so at all times in co-operation with our union Amicus and we are proud of our positive long term relationship with them.

Your Committee asked us about the situation in France. As you know the UK was the only country in the EU to adopt the "provision to derogate" from the original Working Time Directive allowing employees to opt out of a 48 hour week average through collective / workplace agreements. Other member nations may have rejected the opt out but many have found other ways to ensure flexibility, which often means in practice members work beyond the 48 hours over a seven day period. In fact in January 2003 the law was amended to allow greater flexibility

3. Comparative Costs in European Toyota Manufacturing

We mentioned in oral evidence that it is incredibly difficult to compare costs of manufacturing plants across Europe as plants manufacture different vehicles at different levels of capacity. Toyota vehicles are all manufactured to a high global standard but the complexity of the model can vary tremendously (compare a Yaris with a Lexus, for example) and will, by definition, affect the manufacturing efficiency itself. The Avensis, for instance, is built in the UK and is a highly sophisticated, family sized (D segment) vehicle. It is not, therefore, possible to provide a direct comparison with our French plant in Valenciennes, which produces the B segment Yaris. In addition, in the UK we build two models rather than focusing upon one. Indeed in the weld and paint processes both Corolla and Avensis flow down the same line, again making cost comparison difficult.

The Corolla is produced at both the UK and Turkey plants. However, once again direct comparisons are not simple. TMMT produce three versions of the car including the all new Corolla Verso, whilst we produce one version—the hatchback.

During the session Dr Jackson mentioned the level of Corolla investment. To ensure no misunderstanding Dr Jackson was referring to the investment within the manufacturing company (TMUK). The figure of £86 million represents a major commitment made a number of years in advance of actual start of production. To suggest that a decision as to whether a plant gets a new model is taken within a couple of years of production and only if government helps meet some of the costs is disingenuous in the extreme. We do not believe in seeking government support for such investments as this remains a purely commercial decision. We believe that the UK Government's continued financial support for individual car manufacturers distorts the market and we call for a level playing field where operators compete without artificial advantages.

APPENDIX 14

Memorandum by Vauxhall Motors

Vauxhall welcomes the opportunity to make a submission to the House of Commons Trade and Industry Select Committee inquiry into the UK Automotive Industry in 2004. This report gives an overview of Vauxhall and other UK operations of GM and the issues currently affecting our industry.

Vauxhall fully supports the submission made to the Committee by the SMMT.

CONTENTS

1. VAUXHALL MOTORS

Vauxhall Motors is a wholly owned subsidiary of General Motors.

Other GM subsidiaries include IBC Vehicles, Saab GB, Millbrook Proving Ground and GMAC (financial arm). General Motors owns a 41% share of GM Daewoo. It is estimated that General Motors' British operations, excluding retailers, supports 30,000 jobs in the UK.

Vauxhall now has two main bases, Luton and Ellesmere Port, Cheshire. In 2003 Vauxhall produced 130,304 vehicles and over 6 million press stampings. The company is closely integrated with GM Europe in terms of its products, manufacturing processes and information systems. Vauxhall currently has a workforce of 5,500. The company's net income for 2003 was £(109) million.

The UK is GM's biggest market in Europe and constitutes 24% of GM Europe's sales. The UK is GM's third largest market, behind the US and Canada. Vauxhall has a manufacturing plant in Ellesmere Port, Cheshire, and its head office, Warehouse and European Customer Care Centre are situated in Luton, Bedfordshire. The Customer Care Centre serves 20 countries across central and western Europe, dealing with nearly all of GM's European brands.

The Ellesmere Port plant begins production of the new Astra in March 2004. This is Vauxhall's flagship product and thus its success is important for the UK. Products produced at the plant are also manufactured for export under the Opel and Holden brands. In 2003, production at the Ellesmere Port plant increased by 13.9% from 114,377 to 130,304. Total exports increased by 10.3% to 62,116 in 2003. It is interesting to note that, despite the closure of the Luton plant, total UK production only decreased by 0.8% from 2002 to 2003.

Ellesmere Port is also home to the FIAT-GM Powertrain joint venture, which produces the ECOTEC V6 engines for use in FIAT GM Powertrain customer vehicles across the world. In 2003, 88,600 engines were produced for global use, including engines for the Vectra 3.2 V6.

Vauxhall's market share for cars has increased by 0.3% to 12.7% from 2002 to 2003, and the market share for vans increased from 12.1% to 16.4% in the same time period. Vauxhall has the highest fleet market share of 20.8%. Vauxhall was second in the retail market in 2003 with a share of 6.9%. The Corsa and the Astra were, respectively, the second and fourth best selling cars in the UK for 2003.

Vauxhall retailers currently have nearly 500 customer sites. Its Network Q operation (used vehicle initiative) celebrated major success in 2003, winning the title of What Car?'s Best Approved Used Car Programme for the second year running; the only manufacturer ever to achieve this.

1.2 *IBC Vehicles*

IBC is based in Luton and has a workforce of 2,271.

The manufacturing plant produces the Vivaro van, a medium sized commercial vehicle. As part of a joint venture with Renault, it is produced for sale under the Vauxhall, Opel, Renault and Nissan brands. In 2003, 73,930 Vivaros were produced and 52,320 were exported. As a result of a particular focus on van sales, Vauxhall commercial van operations working with the full support of IBC has doubled its volume over the past year. This partnership has seen the introduction of innovative production concepts whereby products have been fully equipped at the manufacturing plant with necessary customer specific internal tooling and equipment for the vehicle to go directly to the road eg AA recovery vehicles.

Up until December 2003, IBC Vehicles also produced the Frontera 4x4 vehicle.

1.3 *SAAB GB*

Saab GM is based in Maidenhead in Berkshire, and has 100 franchised dealers in the UK offering technical and aftersales support. Annual sales in the UK during 2003 rose to the figure of 14,500. The UK is now the second largest market for Saab outside Sweden. All of Saab's products have achieved five stars in the Euro NCAP safety tests.

1.4 *GM Daewoo*

GM Daewoo has been part of General Motors for a year. Its UK base is in Luton, Bedfordshire. $1 billion has been invested in GM Daewoo for the production of five new products, and the introduction of diesel engines over the next three years.

2. Industry Issues

2.1 *Current alternative fuels—LPG*

Vauxhall is committed to reducing the environmental impact of all of its activities from manufacturing processes to the motor vehicles themselves. It is working towards implementing technologies, which are designed to minimise emissions. Vauxhall is proud to lead the way in producing fully warranted Liquefied Petroleum Gas (LPG) vehicles and developing alternative fuel-powered cars.

The Vauxhall Dualfuel (LPG/petrol) range, offers significant reductions in harmful exhaust emissions, including particulates and oxides of nitrogen. Dualfuel vehicles provide an immediate solution to improved air quality and lower levels of global warming gases.

Vauxhall is proud to lead the way in LPG fuelled vehicles with over 60% of the market and encourages the market trend and support for future fuel development and implementation.

Vauxhall was concerned about the market uncertainty created by the announcements in the 2003 Pre-Budget report on the review of fuel duty incentives for LPG. On the strength of Government encouragement, Vauxhall and GM have made significant investments in research and development into LPG, contributing to the Government's aims of meeting climate targets and improving urban air quality.

LPG has significant emission benefits over petrol and diesel, and to encourage direct injection technology and investment into monofuel LPG development, it is looking to the Government to restore stability to the market.

Vauxhall was also the first manufacturer in the LPG/petrol sector to beat the stringent Euro IV petrol emissions standards, which do not come into effect until 2005. We are pleased that the government currently supports the development of LPG by such methods as the exemption for alternative fuelled vehicles from the London congestion charge.

Vauxhall is a keen participant in the partnership between Government, EST and other industry bodies to develop the LPG market through such initiatives.

Today there are around 1,200 LPG filling stations and a new one opens almost every day. Vauxhall worked in partnership with fuel companies to ensure the infrastructure is in place to facilitate this move to cleaner fuels.

Vauxhall's extensive range of Dualfuel vehicles with their low level of emissions also benefit from being placed in a lower Vehicle Excise Duty (VED) band. In real terms this means that for a Dualfuel 1.8 litre Vectra, the annual VED payment would be £110 compared with the petrol models at £155, a saving of £45 alongside the impressive estimated 40% saving on the average annual cost of fuel.

Vauxhalls Dualfuel range is also of particular benefit to the company car user who capitalises on the 1% reduction in the applied level of Benefit-in-Kind taxation. However Vauxhall remains concerned that this is not enough to slow the move to diesel, which the fleet market is currently experiencing. Vauxhall seeks to work with fleet buyers to help them take account of both the environmental and economic advantages of LPG.

2.2 *Future fuels—Hybrid/Fuel Cell/Hydrogen*

In order to add a further dimension to future technology discussions, it was felt helpful to provide some brief information on GM's future fuel programmes. Vauxhall is able to capitalise on the research and development of GMs Global Alternative Propulsion Centre, which is leading the world on Fuel Cell technology. Fuel Cells convert hydrogen into electricity in a chemical process with the only tailpipe emission being water.

The Zafira-based Hydrogen 3 concept vehicle demonstrates the important advances being made in hydrogen powered fuel cell technology by more than 200 scientists at GMs Global Alternative Propulsion Centre. Vauxhall looks forward to being among the leaders in bringing virtually noise and emission free vehicles to the market in the next few years.

Discussions have already commenced with the UK Government on any roadblocks foreseen by GM in this area and are working within the recently established Low Carbon Vehicle Partnership to explore the proposed "Centre of Excellence" for hydrogen and fuel cells.

It has produced AUTOnomy, a concept vehicle that captures the vision and potential of Hydrogen fuel cell technology, and the revolutionary Hy-wire, a vehicle unmatched in both hydrogen and electronic technology.

GM is currently working with Federal Express (FedEx) to validate real world use of fuel cell vehicles. FedEx in Tokyo is running a number of hydrogen fuel cell Zafiras to demonstrate their practicality and reliability. Until hydrogen is available more widely on a commercial basis. Vauxhall/GM are continuing to investigate other alternative fuel technologies that will bridge the gap and ease dependency on fossil fuels. Advanced Hybrid technology is being developed, including a downsized combustion engine and electric motors working together to improve fuel consumption by up to 15% as well as reducing emissions.

The first vehicle of this kind, the GM Sierra, will go on sale in the US in the next few months. Hybrid vehicles will be available in the UK once this technology is proven in smaller European vehicles.

Visionary vehicles are not the only result of GM's commitment to technology innovation and leadership:

- GM has made great strides in solving many of the challenges inherent in fuel cell technology, including the tendency to freeze and stop working in cold weather. The GM fuel cell's freeze start-up time has decreased to less than 15 seconds for 100% power at minus 20 degrees Celsius.
- With its historic expertise in manufacturing and engineering, GM has taken a leadership position in fuel cell technology, systems, controls and gasoline/natural gas hydrogen fuel reforming.
- GM's prototype stationary fuel cell unit already generates power for GM's New York fuel cell development facility.
- In only two years, the power density of GM's fuel cell stack technology has increased tenfold, while costs have decreased proportionately.
- In only eight months, GM developed and delivered the world's first and only hydrogen fuel cell vehicle with an on-board gasoline reformer. GM's revolutionary fuel cell vehicle, Hy-wire, has no internal combustion engine, instrument panel, brake or accelerator pedals—but it does have ample power supplied by a GM fuel cell that runs on hydrogen.

The UK also has the advantage of the presence in the UK of major representatives of relevant industry interests eg BP, Johnson Matthey and BMW (with whom GM are working on liquid hydrogen storage issues). Within GM, Vauxhall has developed a strong reputation for its alternative fuel development and marketing.

The support provided by the UK Government has certainly been applauded and recognised with GM following with interest experiences Vauxhall has had in terms of bringing alternative fuelled vehicles to market. Without doubt this has established a firm foundation for future fuel development and marketing. However, the UK and the EU do need to step up a pace in terms of encouraging development in this area. The US, Canadian and Japanese governments have certainly moved ahead in terms of providing support for fuel cell developments.

2.3 *End of Life Vehicles Directive*

Vauxhall is actively working with the DTI on conditions relating to further regulations. We support the principle behind the European ELV Directive, and we are currently seeking ways to achieve the objectives of the Directive in the most economically efficient manner. For many years we have been developing a range of incentives, such as designing vehicles for recycling, using materials from renewable sources and developing uses for recycled materials. A voluntary agreement has been signed to reduce the amount of automotive waste going to landfill—from 25% in 1997, to 5% in 2015.

We will take back vehicles first registered from 1 July 2002 at no cost to the owner and ensure that certain conditions are met.

2.4 *Employment Policy*

— Information Directive: Vauxhall supports the directive that establishes the minimum requirement for communication and involvement in large firms. Vauxhall and GM Europe already had European Works Councils which meet on a regular basis in order to discuss current issues facing the company.

— Equal Opportunities: Vauxhall aims to match its employee diversity with that of the local community. It also aims to increase the number of women in management. Vauxhall is confident that current policies (covering all aspects of abuse, harassment, bullying, racism and victimisation) ensures that all potential and current employees are treated with respect and dignity. The equal opportunities policy is being updated to reflect changes in the law, and in addition the company is rolling out disability awareness training to employees.

— Stress: As holders of Investors in People, Vauxhall strives to help its employees in all aspects of their work life balance. Courses are available on time management to aid individuals in managing their workload. In addition, Vauxhall also employs a multi-faith Chaplain who is available to talk about any issues of concern.

2.5 *Skills and Training*

Vauxhall has training centres in Luton and Ellesmere Port who have commenced a recent programme of working alongside local public sector training providers and Learning and Skills Councils to offer its employees and its retailers training. This programme will complement programmes already in place.

In 2002, Vauxhall set itself the goal of improving people development, building on the foundations laid by the Vauxhall Social and Ethical Policy at the start of 2002. As a result, the company endeavours to realise and make best use of each individual's potential whilst at the same time ensuring that people are developing the knowledge and skills that will support the positions within Vauxhall in the future. The process is driven by the various business units and reviewed by human resources.

Vauxhall believes more could be done to enhance co-ordinated training support from the public sector to assist the motor industry. Regional policy can ensure that local needs are met but for multi-national companies it would be beneficial to see more co-ordinated national policies.

Vauxhall's retailer body reports difficulties in recruiting and retaining good quality staff—particularly on the technical skills side. This is apparently a pan-industry issue.

2.6 *Pedestrian Protection*

The EU directive's official journal was published in 2001 and states that:

— From 1 October 2005 all new vehicle types will have to comply with two tests concerning protection against head injuries and leg injuries.

— From 1 September 2010 a second set of tests will apply to all new vehicle types and to all new vehicles by 2015.

Vauxhall is pleased this study remained incorporated in the Directive, as was the case in the Industry Voluntary commitment.

2.7 *Vehicle Excise Duty*

Vauxhall is generally supportive of the new CO_2 based VED regime introduced in 2001. It is widely known that other European member states are viewing the UK system as an example of best practice. It is also important that other air quality considerations are taken into account as well—particularly when considering incentives for alternative fuels.

2.8 *Company Car Taxation*

Vauxhall is supportive of the current CO_2 company car taxation regime in the UK. Again it would press that other air quality issues are taken into account. Another problem for alternative fuelled vehicle owners is the fact that for P11D reporting purposes an LPG vehicle is classed as a "luxury option". Thus causing an extra cost burden to customers.

3. Corporate Social Responsibility

3.1 *Environment and Sustainability*

Careful consideration is given to the environmental impacts of Vauxhall's business activities and our products through their lives.

Vauxhall's Ellesmere Port plant was the first manufacturing facility to be environment sound. Each year the plant is recognised by the Green Organisation as a Motor Manufacturer with Green Credentials. In 2002, it won National Gold award for its 14% reduction in general waste, despite a year of major change.

Vauxhall's pioneering CSR work has led to its involvement with the Sigma project. The Government sponsored initiative helps companies to meet challenges posed by social, environmental and economic problems and create a template for sustainable management.

Vauxhall is also supportive of the work of the Low Carbon Vehicle Partnership.

3.2 *Charity support*

Vauxhall is proud of the relationships it has with the communities of Bedfordshire and the Wirral. As such, it undertakes many charity activities and has a philanthropic fund for donations.

Vauxhall's key areas of involvement are education, vehicle safety and hospice care. In addition many of its employees undertake their own fundraising activities, which the company endeavours to support with a cash donation.

Every year, the Vauxhall Griffin Awards are run and these are held to recognise and promote the successes of local community activity in the community of our UK bases of Bedfordshire and the Wirral.

A £10,000 first prize and three runner-up prizes of £1,000 are donated to those organisations that the panel believe will bring most benefit to the local community. Also, one organisation in each region wins the use of a Vauxhall vehicle.

3.3 *Motability*

Vauxhall motability is the premier supplier of motability vehicles in the UK. Vauxhall has the widest range of models, a flexible choice of finance options and depth of expertise to ensure the optimum mobility solution is provided.

4. Commentary on Issues

- It is important the Committee appreciates the current highly competitive nature of the European motor industry. Vauxhall competes for investment on a global basis within the GM family and thus burdensome regulation as listed in the SMMT submission adds to the case stacked up against future development.
- There are few examples of major European car industry players making profit at present. This is due to a number of reasons, mainly over-capacity and a softening in the market in a number of European economies.
- Examples of challenges for the UK industry:
  - High wage compared to Eastern European economies (accession countries),
  - Logistics penalty—which lead pan-European organisations such as GM Europe to prefer to invest in mainland Europe.
  - Different vocational education and skills provided by the Higher Education system in other parts of Europe. The UK's tendency to encourage 16–19 year olds to aim for university level education rather than vocation based training has led to a dearth of suitable candidates for employment. This has hit our retail network particularly hard.
  - Insolvency laws in the UK means that companies such as the joint GM who use worldwide purchasing procedures are reluctant to provide support to UK suppliers.
  - The UK automotive supplier base is hindered from new enterprise due to the burdensome regulations surrounding the establishment of new companies. It takes twice as long to set up a company in the EU compared to the US.
- The European motor industry has recently made proposals to the EC for seeing an improved "partnership" approach in terms of regulation. It is important in terms of the UK Government that they consider the UK perspective on this. Proposals recently put forward include:
  - Introduce a consolidation period.
  - Implement proper integrated impact assessment.
  - Provide sufficient lead time for the industry.

— Increase predictability of EU regulatory process.
— Prioritise EU policy objectives.
— Improve policy co-ordination between DGs and with other institutions and Member States.
— Avoid duplication of consultation procedures.

Vauxhall Motors (UK) Ltd

February 2004

Printed in the United Kingdom by The Stationery Office Limited
9/2004 989036 19585