

Jürgensen, Harald; Berg, Hartmut

Article — Digitized Version

Mergers versus competition?

Intereconomics

Suggested Citation: Jürgensen, Harald; Berg, Hartmut (1968) : Mergers versus competition?, Intereconomics, ISSN 0020-5346, Verlag Weltarchiv, Hamburg, Vol. 03, Iss. 9, pp. 267-271, <https://doi.org/10.1007/BF02930027>

This Version is available at:

<https://hdl.handle.net/10419/138023>

Standard-Nutzungsbedingungen:

Die Dokumente auf EconStor dürfen zu eigenen wissenschaftlichen Zwecken und zum Privatgebrauch gespeichert und kopiert werden.

Sie dürfen die Dokumente nicht für öffentliche oder kommerzielle Zwecke vervielfältigen, öffentlich ausstellen, öffentlich zugänglich machen, vertreiben oder anderweitig nutzen.

Sofern die Verfasser die Dokumente unter Open-Content-Lizenzen (insbesondere CC-Lizenzen) zur Verfügung gestellt haben sollten, gelten abweichend von diesen Nutzungsbedingungen die in der dort genannten Lizenz gewährten Nutzungsrechte.

Terms of use:

Documents in EconStor may be saved and copied for your personal and scholarly purposes.

You are not to copy documents for public or commercial purposes, to exhibit the documents publicly, to make them publicly available on the internet, or to distribute or otherwise use the documents in public.

If the documents have been made available under an Open Content Licence (especially Creative Commons Licences), you may exercise further usage rights as specified in the indicated licence.

ARTICLES

European Motor Industry

Mergers versus Competition?

by Professor Dr Harald Jürgensen and Dr Hartmut Berg, Hamburg *

Individual companies operating in the industries of the EEC countries have not yet reached optimal unit size, which prevents them from reaping the full benefits of the Common Market. They thereby run the risk of being the losers when competing with American corporations that have gained a foothold over here. Cooperation between European companies and concentration between, and among them have therefore become imperative.

The foregoing sentences briefly summarise the prevailing majority opinion. But we should like to counsel caution in facing and swallowing it, because the results of empirical investigations cast doubt on its universal validity. One of the most important growth and export industries is European motorcar manufacture. The authors have analysed this particular industry, and two of their principal findings fundamentally opposed to "prevailing public opinion", as follows:

□ European concerns manufacturing passenger cars—and the following discussion deals only with car production in the narrow sense—are usually sufficiently large for benefiting extensively from the economies of scale emanating from mass production;

□ Most European passenger car producers are also operating on a scale that is large enough for utilising all the chances offered by the Common Market and for competing successfully with the European subsidiaries of American automotive corporations.

Naturally, such findings and theories have to be proved, and the following discussion is an attempt to do so.

* The present article contains a summary of some conclusions of a study undertaken by the authors, the full report on which will probably be published by Messrs. Vandenhoeck & Ruprecht, Publishers, at Göttingen during the autumn of 1968, under the title, "Konzentration und Wettbewerb im Gemeinsamen Markt: Das Beispiel der Automobilindustrie" (Concentration and Competition in the Common Market: The Motor Industry as an Example).

Our information has led us to the conclusion that a high degree of utilisation of the economies of mass production, based on present-day advanced technology, can only be secured from an annual output of between 200,000 and 300,000 cars of one basic model and its adaptations to various purposes.

"Optimal Unit Sizes" of Industrial Concerns

However, this minimum efficient output is only required of the largest European automotive concerns because only they largely operate currently under similar conditions of production as do the "Big Three" of US motor industry. American car producers, in this context, are not offered an alternative, for the wages which they are forced to pay have grown so high that methods using appreciably lower capital intensity, making up for this by higher labour input, are no longer economic in the field of mass production runs. Europe, on the other hand, has not yet reached the same stage of development.

There are European companies which are still able to produce with a lower unit capital input, compared with their much larger competitors, and to remain competitive at prices in the lower ranges of the cars on offer to the motoring public, without suffering material cost disadvantages—including DAF (Van Doorne's Automobillfabriek N.V.), of Eindhoven, which produced 52,000 cars in 1967, and NSU Motorenwerke AG, of Neckarsulm in Germany, with a 1967 car output of about 100,000 units.

In the long run, however, such companies can remain competitive under prevailing conditions of rising wages only if they make one of two possible choices.

Above-average Growth Rates ...

Only this will enable them to supply to the mass markets permanently lower-priced cars, and costs

permitting them to charge low prices can be achieved only by their expansion to similar size as their competitors.

Companies which do not manage to reach more-than-average "endogenous" growth rates might evade a takeover or winding up, as their ultimate fate, provided it will be possible in the future to reduce appreciably the minimum unit output required for obtaining the cost advantages of mass production runs.

Such chances exist if it should prove possible to use car bodies made of plastic materials as an equivalent or even as a superior replacement of conventional steel body work. Estimates which have been presented to the authors show that the range of "low mass-production unit costs" will be reached already at an annual output of only about 60,000 car bodies, should the new construction material prove a full equivalent or even technically superior to steel. Replacing the combustion engine as the prime mover of the modern car, perhaps by fuel cells, might also be very likely to cut down optimal output numbers in this field of manufacture.

It is, however, highly uncertain if and when such new principles will make appreciable inroads into automotive mass production. It is equally uncertain whether smaller car makers will be able to survive until such times when this "golden age" might dawn for them. The authors also believe that their chances for more than average growth speeds are negligible, which makes them predict as their most likely road to successful survival the practice of close cooperation with one of the big suppliers of cars.

... or Production of Expensive Cars

More success is likely in the case of smaller automotive manufacturers turning to supplying only a clientele who are interested in high-priced cars, which means evading a direct confrontation with the big suppliers. The market for the upper ranges of the price list makes it easier to overcome the handicap of relatively high unit costs—because of low unit output, which must increase the share of skilled labour input. The absorptive capacity of such markets is too low for the big manufacturers who channel supplies there to utilise to the full the benefits accruing from mass production economies. Demand, which is represented in these markets by potential purchasers who own above-average quantities of purchasing power, permits to pass on higher unit costs to the consumer.

Economies of Large-Scale Distribution

Economies of large-scale distribution may result from turnover volumes above a floor value, above which decentralised car assembly will be more economical than centralised assembly plants. This may enable the manufacturer to supply regional markets more rapidly and at lower cost than before.

Other economies of scale will result from average advertising and promotion costs per unit sold showing a declining trend with rising turnover volume, which again will be reflected by a downward trend of overall unit costs.

Finally, economies of scale may be gained through a sufficiently efficient and tightly-knit network of car dealers and clientele servicing stations, which requires a turnover volume higher than the floor quantity sufficient for obtaining low mass production unit costs.

Decentralised Car Assembly Plants

Whilst in the United States car assembly plants play an important part in supplying existing markets, no extensive use has yet been made of such facilities in Europe. With the advance of economic integration, there are, however, car manufacturers whose deliveries to the markets of other EEC states are reaching quantities which may soon make it attractive to them economically to place assembly plants in an important local market. That such chances may soon be utilised is not unlikely.

A trend towards such developments, however, does not carry any compulsion to further company mergers. Because:

☐ assembly plants reach their optimal size, under present-day conditions, already at a relatively low unit output—of between 25,000 and 50,000 units p.a.;

☐ most European motor concerns have already reached sufficient size and strength for being able to finance construction, purchase, or leasing of assembly plants of their own, and for utilising their capacities to the full;

☐ smaller producers will hardly feel a disadvantage from their manufacture remaining centralised, at least as long as they are content to serve the markets for rather expensive cars—since the more a car costs, the smaller is the share of transport costs in its retail price to the purchaser, and markets for such expensive units of individual transport do not usually sustain sufficiently large turnover volumes for making it worth-while even for large producers to decentralise the assembly of their more costly cars;

☐ usually, it is highly unlikely that geographical distances between the different locations of car production carried on by motor manufacturers registered in the Common Market Area will be large enough, and after tariff barriers have fallen, there will also rarely subsist the need for "jumping tariff frontiers", so that decentralising production will hardly become equally attractive as in the US.

Promotion and Advertising Costs per Unit

Smaller manufacturers naturally spend less than bigger ones on advertising and promotion, in actual amounts of money, but per manufactured unit, their advertising outlay will be bigger. However, it is easy to overestimate the competitive disadvantage hitting

the smaller man from this source, for it seems to be the rule for the motorcar markets that the highly interested potential purchasers draw their information on supplies through a multitude of communication media. This makes the market for cars transparent to a degree which is much superior to that of comparable markets for other durable consumer goods. Availability of this mass of information makes a big contribution to the smaller motor manufacturers overcoming the competitive disadvantages arising from the relatively modest sums they can spend on advertising and product promotion. Enquiries made of German purchasers of motor cars about the type of information which determined their choice of car which they eventually bought have confirmed these observations.

Dealers and Service Stations

Big concerns, including Volkswagenwerk AG, Adam Opel AG, and Ford-Werke AG at Cologne, all maintain networks of appointed dealers and service workshops operating under contract which are probably more efficient than those serving their smaller competitors but certainly much more comprehensive, and this must surely yield them measurable competitive advantages. But this superiority seems only to operate within narrow limits, which can be seen from the following facts: smaller German motor manufacturers, whose dealer and service station networks provide a far less comprehensive cover of the market, are obviously still able to earn sizeable net profits, against and in the face of such handicaps. French and Italian car makers naturally have much more modestly developed service station networks in the German markets than the big German manufacturers, and yet, these companies have acquired a relatively strong position in the German automotive market within a short period.

It may be a suggestive idea to save time and costs for building up a comprehensive service network in a newly entered market by associating for the purpose with one or more other car manufacturers, but only very few manufacturers have used this strategy, and those who did, trod this path hesitantly and did not bring home rousing successes.

What is called the "solus system" in the United Kingdom, through which dealers and repair mechanics

are tied exclusively, by contract, to a single motor manufacturer and his brand name, seems to have proved its worth in the past. To throw this system overboard appears abhorrent to most motor manufacturers, probably because the producer is afraid to lose the power to determine and supervise the business policies of his dealers, should the dealers be allowed to represent the interests of more than one manufacturer.

Perhaps, the types produced by different makers of cars compete with such immediacy and directness that it appears to be a matter of fundamental competitive policy for one manufacturer not to be willing to be represented by a dealer who also sells for his rival, and vice versa.

During recent years, almost all the bigger manufacturing concerns have followed a strategy of widening and broadening their programme of car types. It is their aim to provide at least one basic model in all the important price groups, with its variations, and the nearer car makers approach this aim, the less likely will be the possibility of more than one car maker using identical dealer and service station networks, because adjusting production programmes of two or more firms to each other would require such a degree of shedding "sovereignty" which is usually conceded only in the case of a full merger.

Economies of Large-Scale Buying

Though the smaller motor manufacturers are of relatively inferior size, compared with their mammoth competitors, none of them are really truly small-scale firms. On the contrary, they all qualify for the exclusive club of the hundred largest corporations of the country in which they are registered.

"Smaller" motor manufacturers are likewise usually much larger than most of their sub-contractors and suppliers, which means that their bargaining power is of sufficient strength for their fully using the potential economies of large-scale buying. Even in cases of suppliers of smaller automotive concerns being of similar or even superior size in relation to their clients it is highly unlikely that such suppliers will contract their deliveries or services at noticeable worse conditions than those which are available to the larger automotive competition. For, their con-

VEREINSBANK IN HAMBURG

Established 1856

HEAD OFFICE: HAMBURG 11, ALTER WALL 20-30, TELEPHONE: 361 061
49 BRANCHES AND AGENCIES IN HAMBURG, CUXHAVEN AND KIEL

siderable absolute size and consequently also the volume and value of their purchases are sufficient to make them attractive clients for every supplier.

Size of Company and Innovations

It is the same both in the US and in Europe: the big motor manufacturing concerns usually cannot match the technological innovations introduced by their smaller competitors, and they never surpass them in this respect.

Like every other rule, this truth has its exceptions: for the Daimler-Benz AG, the Fiat SpA, and the Régie Nationale des Usines Renault undoubtedly all have reason to be proud of certain pioneering achievements of their own. But this does not invalidate the statement: further concentration of European automotive manufacturing activities would rather reduce the credit account of advanced motoring technology accumulated for the benefit of European car makers, than improve it.

Smaller makers of motor cars, and this is the rub, are compelled by a much stronger force than their bigger rivals to be inventive, since only in this way can they hope to compensate the bigger marketing power of the colossi. As to their capability of initiating innovations the actual achievements of smaller European car makers are sufficient proof that their current size, which—measuring in absolute terms—is considerable, is fully sufficient “to pass the initial threshold level of research and development expenditures below which a research programme dictated by the technology of the industry is simply not possible.”¹)

The Financial Problem of Flexibility

Manufacturers will enlarge their production capacities and try to expand their dealer networks when they experience growth and expect it to continue. Such moves will hardly present manufacturers with problems of finance. But things are different in the field of product policy. A manufacturer may feel compelled to respond to the announcement of a new car model by a bigger competitor by bringing out a new model of his own, even though his profits may currently not come in at a highly favourable rate.

However, the volume of investments made by smaller European motor manufacturers in recent years has shown that, under normal conditions, they can easily manage to broaden their programme of car types, to vary its styling from time to time, and to replace models which have lost their attraction to potential purchasers by novelties.

Model change, naturally, must not come too fast and too frequently. A model which will be produced for one or two years only, to be replaced after such a short run by a new one, could not be offered to the trade at competitive prices by smaller manufacturers, as the number of units made and sold would be so

small that each unit must carry much too high average styling and tooling costs.

The companies threatened by this danger have long ago recognised the risks involved. That is the reason why they attempt to maintain in being a successful series of models for as long as possible. It cannot be gainsaid that this strategy has been highly successful in recent years, and it is very likely that it will prove its worth in the future, too, for everything in European car making seems to indicate that the rate at which models are changed and superseded will not accelerate in the years to come.

Even the big European car manufacturers seem to feel scant inclination to emulate the American “Big Three” in their introducing the principle of “dynamic obsolescence”. To quote a number of examples: Régie Nationale des Usines Renault, Fiat SpA, and Daimler-Benz AG, all have used the last years to bring out models whose look has been deliberately chosen to be “timeless”, so that they can be produced over a longish period without decisive alterations.

It seems that the interests of both big and smaller motor manufacturers in this respect are broadly similar. This gives greater stability to the present structure of the industry, especially as we cannot believe that the European subsidiaries of the American “Big Three”—provided they want to do so—would be able to force their European competitors to give up their strategy of great caution in changing their car models. This is not to deny that smaller companies will always lead a more precarious existence, more exposed to the threat of extinction, than the giant suppliers.

But it is impossible, in our view, to argue validly in favour of an appreciably higher degree of capital concentration in the European automotive industry by alleging that existing unit sizes of individual car production companies are still too small for being “optimal”. Naturally, this statement of ours lays no claim to permanent correctness; on the contrary, it will always be possible that basic facts going into a similar assessment, at a later date, will have changed, which would make it imperative to re-define the notion of “optimal unit size” for a European motor car company.

Dangers of an Escalation of Company Mergers

Under present conditions, more numerous company mergers would not only fail to produce palpable benefits through economies of scale from mass production but it might even distort competition and endanger its survival. If there would be a vast merger movement in any one of the EEC member states, this would very probably produce parallel reactions in the other EEC countries.

This would set up a threat of escalation, in the course of which the number of economically independent suppliers to the car market would decline steeply as against the present position. European automotive

¹ D. Swann, and D. L. McLachlan, *Concentration or Competition: A European Dilemma?* — Published by PEP/Chatham House, The European Series, No. 1, London, 1967, p. 20.

markets would then assume the form of a "narrow" oligopoly, as defined by Kantzenbach.² Such a type of market, through the high degree of interdependence between the members of the prevailing oligopoly, might easily result in such strong restrictions of competition that they far transcend the borders of what could be considered admissible for the purpose of avoiding cut-throat and ruinous competition.

Under conditions of a narrow oligopoly, competition would only be kept alive through the strong opposition between, on the one hand, a phalanx of jointly-operating European manufacturers and, on the other hand, the subsidiaries of the American "Big Three" which have been established in the Common Market Area, and such a possible situation appears to us far less attractive, from the point of view of antitrust policy than the present set-up.

The Age of Challenge

Up to the early 'sixties, competition was not very keen, so that the period leading up to this watershed might be dubbed "The Age of Peaceful Coexistence". It then gave way to an Age of Challenge. European automotive markets gradually changed their structure, and their main features now are:

- ☐ growing inroads of foreign car suppliers who are gaining a foothold in the traditional preserves of local producers;
- ☐ all the larger manufacturers following the same policy of widening and broadening their type programmes, so that they may be able to offer at least one basic model in every price group, with its variations;
- ☐ relatively moderate growth rates of demand, compared with the preceding period, paralleled by the availability of production capacities that are usually capable of meeting such demand without delay;
- ☐ growing homogeneousness of supplies, based largely on the established fact that car models supplied by foreign producers are valued by the large mass of potential purchasers as increasingly equivalent to the production ranges of local manufacturers.

It is well known what are the results of such changes of basic data. The German motor car market provides the clearest illustration of the consequences, because opening up the market to outside influences has so far made most progress in Germany. Every single car producer operating from a home base in the Federal Republic of Germany is now confronted, in the particular market which he has been serving by preference in the past, with various competitors, most of whom have at their disposal comparable production potentials, and who will not leave the indigenous car maker in any doubt that they intend to use an offensive strategy.

For increasing their market share in West German domestic car sales, foreign makers use the following

tools: an attractive programme of car types, meeting more closely the wishes of potential German purchasers than in previous years, including a better finish; active work for expanding rapidly the foreign makers' network of service garages; advertising and promoting campaigns which use sufficient funds to make them as conspicuous as the efforts of German manufacturers, and—last but not least—a price calculation which has attracted the almost open reproach that they use cut-throat methods akin to dumping.

Added to the effect of making competition much keener through the appearance in the West German market especially of French and Italian car suppliers, the ruthlessness of the struggle for sales has undoubtedly grown by the coincidence of this invasion with the deceleration of market growth: rates of increase in demand for private cars have become much more moderate than they were, and total demand, of which replacement and spare part requirements are forming a growing part, has become much more sensitive to changes in business climate.

Decision Making Under Conditions of Uncertainty

The overall effect of all these influences appears to be a state of the market which largely fulfills the desire for optimal forms of supplying consumers' needs, for the width of choice and possible selection offered to potential users of cars has grown appreciably. Increasing keenness of competition results in growing pressures upon prices and profits. Elimination of a large number of small suppliers seems also to have led to a state of affairs in which it is highly probable that all the economies of scale flowing from car mass production runs are currently in virtually full use.

Naturally, this favourable balance of forces will not be of permanent duration, so to say, — we live in a new phase or age whose length and eventual outcome cannot be foreseen with any degree of certainty. Important influences which will determine the actual direction of further evolution—e.g. the forms which the EEC will find in the future, and the Community's future relations with non-member countries—are mainly political in character, which means that no farsighted economic speculation can disclose anything of their future shape.

But even purely economic factors, as they are operative today, must not be simply projected into the future, especially as European automotive markets are anything but a closed shop. There is always the possibility of new and powerful suppliers, for instance, the Japanese, invading these markets. Whether such outside competitors will make serious inroads at all, how they will try to do so, and when this will happen cannot at present be predicted. This means that management tasks of the European motor industry, as the tasks of so many other managements, will comprise as one of their most important ingredient, and to a rising degree, the making of decisions under uncertainty.

² E. Kantzenbach, "Die Funktionsfähigkeit des Wettbewerbs", 2nd edition, Göttingen, 1967.