

## PERSPECTIVE AND STRATEGIES IN AUTOMOTIVE INDUSTRY

**Isac Nicoleta**

University of Pitesti, Faculty of Economic Sciences Blv. Republicii no. 71, postal code 110014, Pitesti, Argeş  
nicoleta\_isac2004@yahoo.com 0722.25.34.33

**Manole Victor**

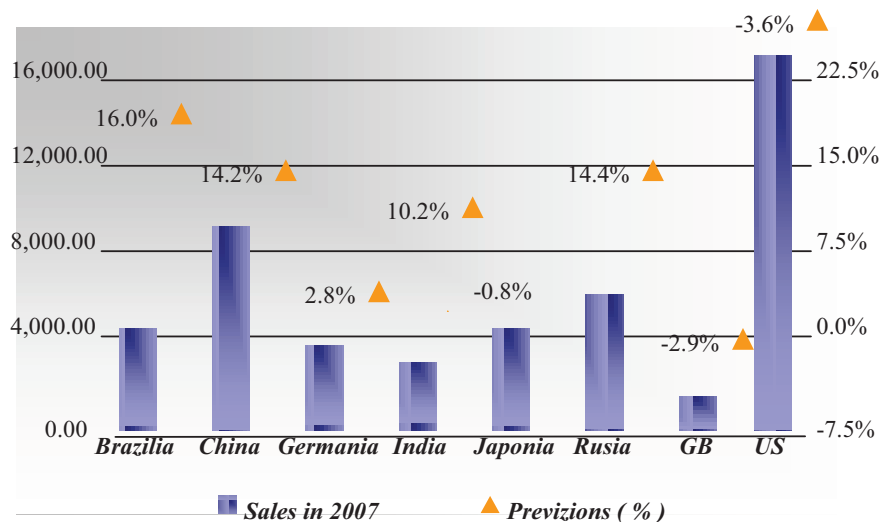
Bucharest Academy of Economic Studies Faculty of AgroFood and Environmental Economics  
victormanole@eam.ase.com 0722.32.97.33

*In 2008, all that has changed. The momentum of optimism has been checked: companies are now confronted with a world gone into reverse, where growth is highly uncertain and where prices and financial conditions are highly volatile. This change is visible in many areas. It is visible in lower expectations for revenues and profitability, higher expectations of bankruptcy, and more pessimism on the speed at which the industry can adapt to challenging conditions. More companies expect overcapacity to emerge in key regions, and that sales and production growth will fall in emerging markets in particular.*

*Key words: quality, management, automotive industry, crisis*

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According to the Economist Intelligence Unit (EIU), global passenger car sales are expected to rise at an annual average of 4.0 percent during 2008 – 12 (reaching approximately 67 million units in 2012), a slight improvement on the 3.4 percent rate recorded during 2003 – 07. The increase will be driven by demand in China and India. However, automobile sales in the developed world will remain disappointing.<sup>2</sup> According to a global automotive outlook survey conducted by Dykema in 2008, approximately 98 percent of participants suggested that in 2008, passenger vehicle sales will drop below 16 million units in the US.<sup>3</sup> According to Carlos Gomes of Scotiabank Group, approximately 13.7 million passenger cars will be sold in the US during 2008.<sup>4</sup> Figure 2 presents the forecast for passenger car sales across geographies in 2012 and the compound annual growth rate (CAGR) for the period 2007 – 12.



**Figure 1: Forecast for passenger vehicle sales in 2012 and the CAGR for 2007 – 12**

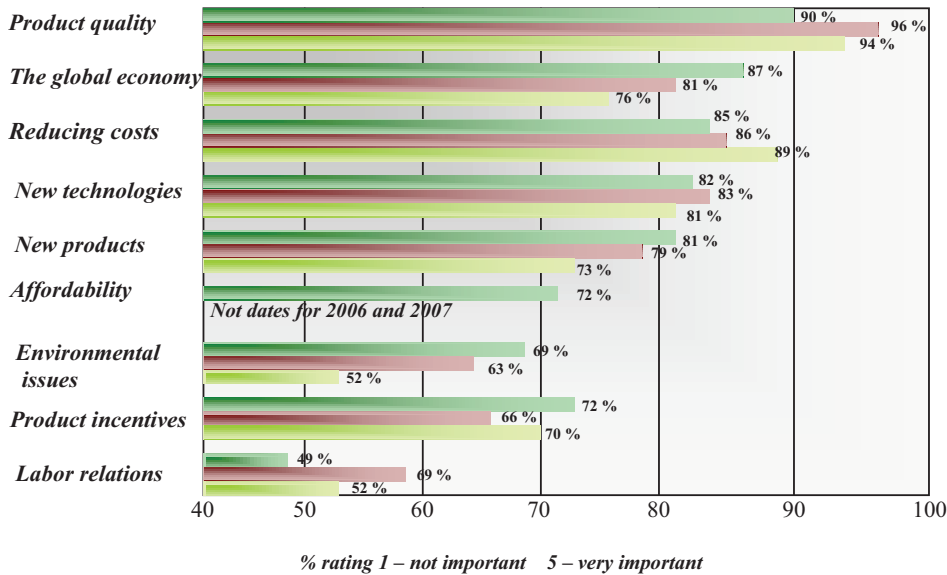
*Source: World Data, The Economist Intelligence Unit, 2008*

It is clear that the near future is going to be very tough for the automotive industry, also shows that long-term many companies are well aware of the concerns have not greatly changed but on long-term trends, opportunities and challenges, companies continue to say they retain a long-term focus on innovation and technology – particularly fuel technologies.

The 2009 Survey suggests that innovation and technology are likely to be at the heart of industry efforts to recapture profitability in the coming months and years. For example, innovation – especially process innovation – is still seen by companies as the best way to cut costs, rather than attacking direct overheads. Companies also believe that product innovation will be key to rebuilding sales: it is notable that despite the fall in energy costs during the last few months, expectations of sales of hybrid and other fuel-efficient vehicles continue to rise sharply compared with previous years.

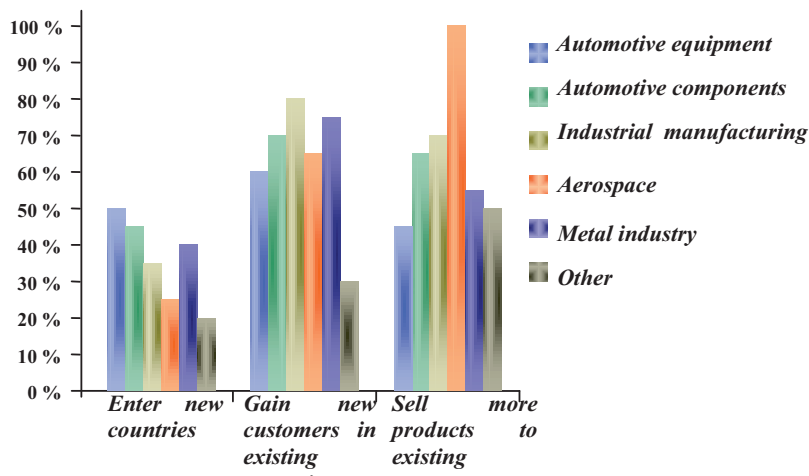
Still, the mood of the world's auto industry has reversed: after the relative optimism of 2007 with its expectations of a gradual return to stability and prosperity, expectations in 2008 have changed for the worse.

The most important issues for the industry overall – the question that reveals the relative weight of long-term concerns – in 2008, the deterioration of the global economy rose to second place (from fourth place in 2007). While traditional long-term concerns hold their place in the rankings of overall issues (product quality remains the most cited issue, for example) companies have been consistently forecasting a deterioration of overall global growth for the last four years, with concerns about the global economy rising year on year from 2005. However, the number of companies citing labor relations as important has fallen in 2008: just under half of companies rate labor relations as important in 2008, compared with 59 percent in 2007. The number of companies rating labor relations as unimportant has also risen sharply from 9 percent in 2007 to 16 percent in 2008. This is consistent with the deterioration of confidence in other areas in 2008: while last year companies remained concerned about labor shortages – especially in the fastest expanding markets – in 2008, they appear to expect their key labor markets to loosen.



**Figure 2. How important is each of the following issues to the current state of the auto industry**  
*Source: KPMG Global Auto Executive Survey 2009*

When Companies were asked: which of these is the main business growth strategy for your company over the next five years? report that their growth strategies are more concentrated on winning new customers and new business in existing markets than on entering new markets. However, in interviews, companies stress that in many cases they are already active in new markets, and therefore count.

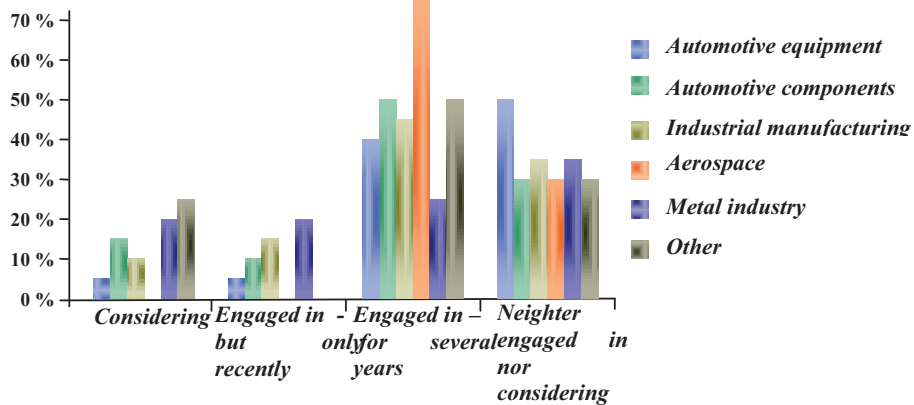


**Figure 3. The main business growth strategy for company over the next five years**  
*Source: KPMG International 2008*

Two issues dominate corporate concerns regarding sourcing from or manufacturing in low cost economies: cost and quality. Some companies surveyed also voice concerns about the challenges of managing through joint-venture approaches, but these are in the minority as most companies report that the manufacturing that they consider critical is almost always accomplished through wholly owned subsidiaries.

Many companies surveyed remained concerned about the achievement of quality in emerging market locations. However, companies with manufacturing operations in intermediate cost locations – such as economies on the European periphery – frequently report very positive results on both cost and quality. “We have more quality issues in high-cost countries than in low-cost countries,” says one European industrial machinery maker. “We make all our critical components in places such as the Czech Republic and Portugal: we have low cost and the highest quality.” And this company adds: “achieving quality from low-cost markets is entirely dependent on how long you have had to manage the issue”.

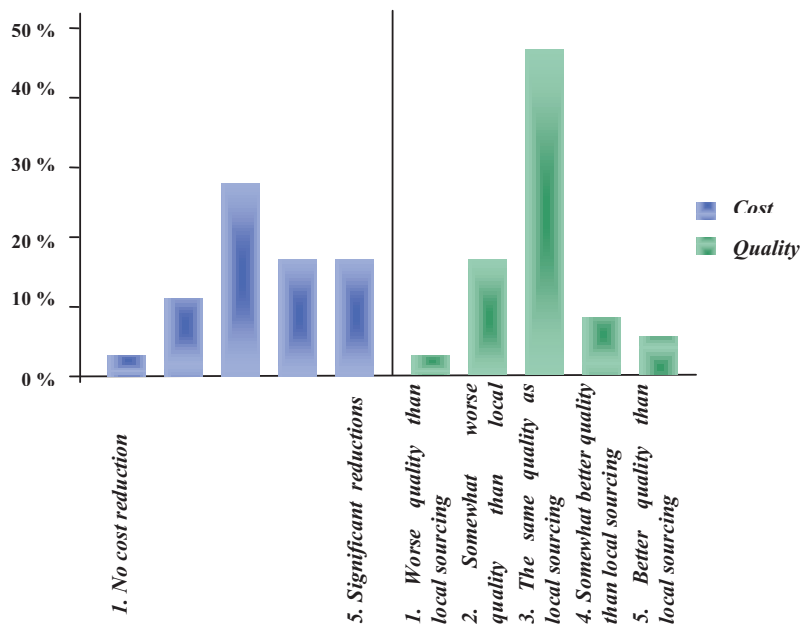
Manufacturing in low-cost east Asia – especially China – is more problematic, although several companies argue that quality failings are often the fault of the manufacturer rather than the location. The CFO of one large east Asian auto components maker says that his company remains reluctant to commit to manufacturing in China on quality grounds: “quality is very important to a manufacturer in our business. We make things like brakes – these are critical components that lives depend on. We would do a lot more manufacturing in low-cost locations if we could be sure of the quality”.



**Figure 4. The importance of low-cost country sourcing for production**  
*Source: KPMG International 2008*

A large Indian auto parts maker with global auto customers adds that “on quality, we consider India to be as good as it can be. China is not so good, but training and investment will push that quality up. There is no doubt that quality is the biggest challenge in low-cost country sourcing, and getting and keeping the right skills is the next most difficult issue”.

Almost without exception, companies report that productivity rather than direct labor cost is the key to profitable manufacturing operations in new markets. “Labor costs are not increasing,” says a large Indian auto components maker with global customers. “The cost per person is increasing, but so is productivity – so overall there is no cost increase.



**Figure 5. Significant low-cost country sourcing was in terms of cost and quality on a scale of 1 - 5**  
*Source: KPMG International 2008*

**Conclusions:**

The automotive sales outlook for key markets in 2008 is gloomy. In addition, with increasing commoditization of vehicles and very little to differentiate among them, the emphasis shifts towards a better retail strategy. In most of the major automotive markets, vehicles are sold mainly through franchised dealers. There has been a shift towards multi-brand dealerships in almost all the key automotive markets, which allows customers to test and compare various vehicles at the same location. Another major trend seen in the automotive retail industry is the consolidation of automotive dealerships. However, despite consolidation, global automotive markets remain fragmented with scope for further consolidation.

The automotive industry is clearly facing an unprecedented crisis, a crisis that companies fully expect will reshape the industry. But even amid crisis conditions, the long-term concerns of automotive companies remain strikingly stable: developing and leveraging technology in an era of gradual but inexorable shift away from oil dependence. One of the lessons of the 2009 survey is that companies that manage that shift successfully are likely to be the industry leaders of the future.

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