Dr. Engelbert Wimmer | 20.02.2014

THE GROWTH ADVENTURE.

New markets for the automotive industry in the “post-BRIC” period.

Only yesterday, the monetary sluice gates were being opened to prevent the looming financial meltdown in the global economy’s engine room: today, confidence is returning. Of course, there are those of us who query China’s continuing wirtschaftswunder, but that hasn’t stopped the world’s stock exchanges reaching new heights (by way of occasional lows), pulling the two-hundred day trend curves upwards. Meanwhile, exports are booming, and Doomsday has, it seems, been rescheduled for a later date. The automotive markets, too, are once again showing signs of life, with the sales from the 16 most important carmakers in 2013 climbing to 71 million vehices: by 2020, the 90-million mark will be in the rear-view mirror and, given demand from emerging economies, growth in the market is set to hold at over three percent, rather than the 2.5 percent that have been the order of the day over the last fifty years.

At car shows worldwide, the sound of corks popping has returned. The US had sales of over 15.6 million units to celebrate for 2013, and our predicition is that this market will hit 16.2 million in 2014, showing a convincing return to previous form. At the same time, the European market ought to have reached the bottom and looks set to stabilise at 12 million: a slow recovery is now to be expected. Yet in contrast to the United States, Europe did not make use of the crisis to shed excess capacity, which can only mean that the coming years will see another round of “musical chairs” in the highly-competitive automotive market: consolidation at all levels of the supply chain will continue – and it will be ruthless. From previous years, we know exactly how high the price of late arrival in important markets can be.

In the dance around the few remaining seats, it would seem that speed of reaction, stability, and agility are all required in equal measure. At the same time, an instinct for where future growth can be expected away from the stagnant domestic European and untapped American markets will be needed.

We have produced an overview of which markets will show growth and will be taking a look at their key features:

1 | BRIC – STABLE PRESSURE

The top-spots for the traditional BRIC markets have been bagged for the coming ten years, but will take effort to hold.

2 | “THE GREAT MID-CAP MARKETS HOPE”, OR: GROWTH OFF THE BEATEN TRACK

There is a range of medium-sized markets currently showing stable growth in car sales. Cue the battle for the “new medium markets”.

3 | LIGHTS VISIBLE ON THE “DARK CAR CONTINENT”: AFRICA’S AUTOMOTIVE MARKETS FINALLY GET OUT OF FIRST GEAR

The French in the North, the Germans in the South, and – for a few years now – the Chinese new arrivals more or less everywhere.

4 | NEW BUSINESS MODELS: A NECESSITY FOR SUCCESS ACROSS THE AUTOMOTIVE DIASPORA

Lower production runs and ultra-diverse production and market conditions require new business models from both OEMs and suppliers in moves to tap potential.

1 | BRIC – STABLE PRESSURE

In recent years, the prospect of solid growth and lucrative profits drove the global automotive manufacturers and their suppliers to bet big in Brasil, Russia, India, and China. And while these markets will of course continue to be central areas of activity in the worldwide car market in a wider sense, the capacity which has been piled into the BRIC countries means that even today, the pressure on profits is murderous and these markets have become cutthroat environments.

Even in extremely high-growth markets such as China, which will make up around 40% of global sales by 2020, the situation is tense. The difficulty of transferring profits back out of the Middle Kingdom make reinvesting locally look lucrative by comparison, which in turn has led to an arms race between manufacturers and their suppliers and to levels of capacity which remain ahead of the actual sales in market. Then there are the new Chinese manufacturers, who are beginning to emancipate themselves from their foreign joint-venture partners and strengthen their position with own-brands and supplier networks.

This level of pressure can only be withstood by a few well-established competitors with mutli-national structures. Defending the positions taken over the past years will continue to require huge efforts: trust will need to be invested in local subsidiaries, followed by massive localization and more developed sensitivity in handling partners in market.

As a whole, the lines have more or less been drawn in the scramble for the BRIC growth markets – at least for the coming decade. In order to find new growth impulses, the strategy departments at both OEMs and suppliers have switched from hyper caution to careful acceleration mode and are now actively looking for stabilizing markets away from the “Usual BRIC Suspects”. This search takes on all the more importance in view of the fact that the manufacturers and suppliers have both become used to a profits stream from growth markets and would not be able handle serious shortfalls in demand from their major sales regions in the event a new crisis.

2| „THE GREAT MID-CAP MARKETS HOPE“

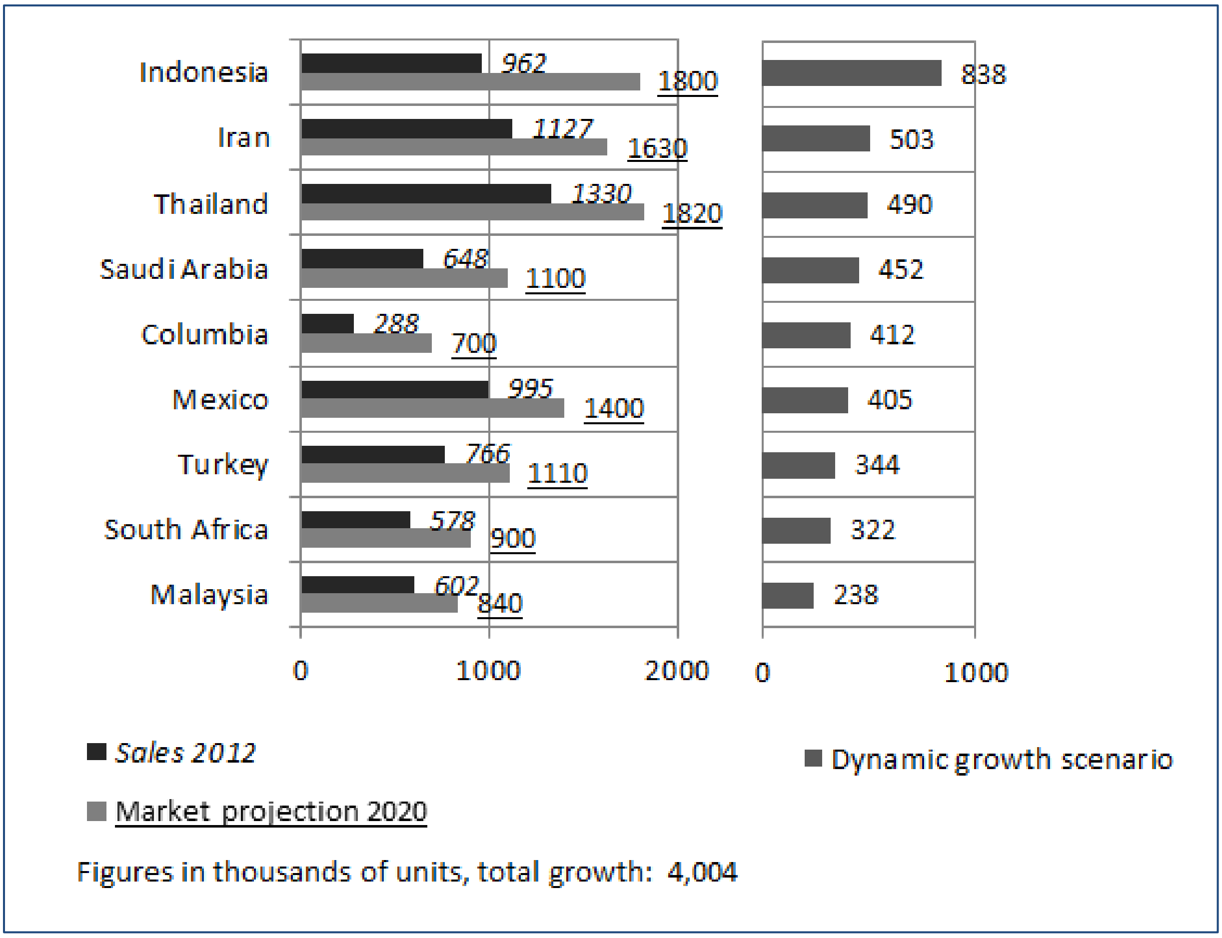

Figure 1: Sales figures, mid-cap markets (Data source: POLK and polariXpartner)

As it happens, there is a whole list of countries which, according to our forecasts, could offer not only volumes of a sufficient order, but impressive growth.

Our analysis was conducted by filtering for countries which are set to reach total sales of at least 500,000 vehicles by 2020, with (cumulative) growth from today to 2020 of 30 percent or more. The results are composed of nine potential candidate markets which, taken together, will offer much more in terms of growth than current total sales in the German car market.

While the growth expected here will, as mentioned above, not reach the same levels slated for China, this least nonetheless reveals potential areas which were, for political reasons, barely on investors' world maps until recently. Yet already today, these countries' solvency can (for the most part) be guaranteed by raw materials or by their existing connections in global trade flows; further, most of these markets already show per-capita GDP values which are comparable with those of many peripheral EU countries, with economies built on the broad shoulders of diverse, well-established medium-sized companies.

WHAT IS THE BEST STRATEGY TO GO ABOUT INVESTING THESE COUNTRIES?

Classic investment projects in the form of new production sites are, given the high volatility of these markets and a wealth of local peculiarities (e.g. sudden barriers to trade, a lack of suppliers, extremely specific expectations with regard to products and costs), frequently not to be recommended. In order to be able to work within the climate of political and economic risks, local connections and in-country knowledge of the kind only partnership models with established local industrials can provide are the backbone of investment strategies here.

It is of primary importance to approach negotiations with potential partners without condescension and not to misinterpret the demanding posture adopted by local companies. Riding in on horseback and talking down to “the natives” is a sure fire way to leave empty handed: although, in global investment terms, these ventures may be small fry, the local champions are putting the family silver and employment across swathes of their countries on the table, so creating trust by developing long-term securities is a must. Lasting partnerships will be built for both parties by talking openly about cash-flow and risks, as well as by producing product planning that is as clear as it is clever, able to combine tactical low-cost demands in today’s market with the long-term flexibility to move up the product scale.

Ways to build trust include actively integrating family members of the local captains of industry and supporting management talent in international partner organizations: this will ensure long-term security in the partnership. Exchanging licenses, patents, trade rights, supplier relationships, or equity options are other possibilities.

Nevertheless, the problem remains that a respectful tone in dealing with family businesses from the target countries is often something of a challenge for managers from established concerns with the end-of-quarter figures at the forefront of their thinking. The fact that local partners will usually be unable to make investments for one manufacturer alone, but will often have to spread them across several brand empires, presents an even greater challenge to their capacities for humbleness and long-term-ism.

Yet if the partnership works, either semi or completely knocked-down works could be created in countries which have not been vehicle producers to date; there is also the possibility of completely new suppliers growing in the market. In many cases, it is only the entry of a local partner onto the scene that can get outsiders with requests regarding development initiatives, changes to regulations, or investment protection a hearing with authorities and governments. North African countries an example of these phenomenon, where French automotives have been successful in grouping their interests.

It may require a lot of patience, but in the countries listed, a range of opportunities can be opened up all along the automotive value creation chain, even if large-scale one-off investment projects are not viable in the same way as they are in BRIC. Those, however, who view the Japanese-Korean occupied ASEAN markets or the somewhat closed Mercosur environment with skepticism would do well to take a look at the planet's second-largest continent:

3| AFRICA'S AUTOMOTIVE MARKETS GET OUT OF FIRST GEAR!

The secret about the economic dynamism of Africa, especially in the strong south and Mediterranean northern belt, is well and truly out. With a sixth of the global population and more than a fifth of the earth's land surface, however, the continent has often been held up as the market of the future, meaning that globally active medium-sized companies and multinationals alike have traditionally been skeptical with regards to African markets. In fact, there is no shortage of ghost sites to cool optimism and curb enthusiasm: the difficult Volkswagen entry into Angola and its subsequent retreat stand as a cautionary tale. Yet growth in Africa has stabilized and is no longer an intermittent phenomenon: sustainable expansion is the new reality across Africa. According to our analysis, the African market is set to grow by 750,000 units to 2.5 million vehicles annually by 2020, with around 50% of these sales on the northern coast. Our market forecast is based on the following developments in sales figures across the whole African market:

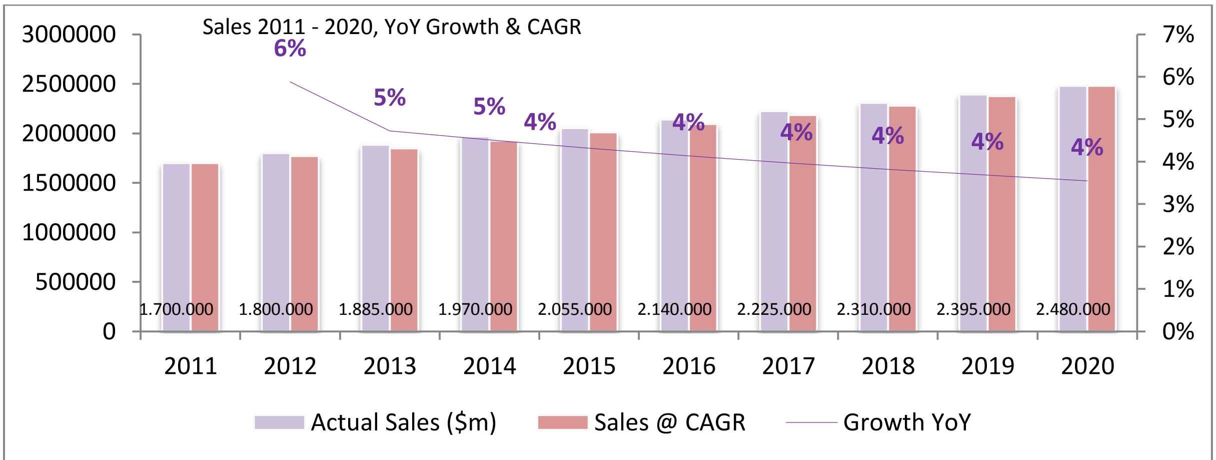

Figure 2: Sales development, YoY growth and CAGR, data source: POLK and polariXpartner

With the exception of some “lost countries”, most African states are showing real progress in macroeconomic terms and in improving the overall economic climate, for instance by removing burocracy and offering targeted industrial development programs. In this way, the sub-Saharan recorded average annual GDP growth of 5.7% between 2000 and 2011 alone, with 4.9% growth every year expected from 2012 through to 2016: that is twice the global growth forecast for the same period, and half of the world’s strongest growth nations are in the sub-Saharan region of Africa.

Thanks both to comprehensive debt reduction and development initiatives to cancel debts, the financial situation of African countries has in general become much more stable. In the 1990s, the average debt-to-GDP ratio was around 80%; today, this figure has declined to below 60% - with an even clearer drop is several individual countries. Other macroeconomic indicators are also pointing in the right direction, with the overall rate of inflation across the continent dropping by 14% to 7% between 2000 and 2011; at the same time, production capacity doubled.

The new-found success and potential of the continent are down to more than just development aid and natural resources (even if Africa does have over 10% of global oil and 40% of gold reserves, with around 85% of the planet’s chrome and platinum metals). The African middle class, which – with around 313 million members – is already larger than the entire population of the USA, or roughly the same size as that of India, is growing at five million a year; urbanisation too is increasing at 3.5% annually, meaning that the continent will in the foreseeable future have the world’s largest labour force, with the accompanying healthy and constant appetite for transport. The average age in many African countries is below 20, which compares to 30 in Asia and 40 in Europe: while the working-age population in particular in China is declining rapidly and India is headed for peak labour, Africa is forecast to continue growing in this metric beyond 2050 even.

Transposed onto the automotive industry, this correlation of factors combines to produce a sustainable, sizeable growth scenario for the future. Just comparing absolute sales growth across Africa between the first six months of 2012 and of 2013, the figure was 5.9%. This value confirms our analysis that the 13 strongest-growth countries in Africa posted average growth of 5.5% between 2002 and 2012. The question is thus no longer whether Africa will become the next success story, but solely: when and how?

RATATOUILLE IN THE NORTH, SAUSAGE IN THE SOUTH …

The automotive market in the north of Africa is more or less dominated by the French manufacturers, who have traditionally enjoyed intensive economic links with the Magreb zone on the Mediterranean coast; despite the considerable infrastructural difficulties involved, the French have been producing in-country fro some time. One example is Renault in Tanger, Marocco, which opened a large car factory there with its partner Nissan in 2012: with its modern harbour only 13 kilometers from mainland Europe, the works should have a capacity of 400,000 units by 2015 (currently 200,000) serving the African market and beyond.

Meanwhile, the south of Africa has traditionally been German territory in automotive terms. Daimler, BMW, as well as Volkswagen and MAN all produce in-country in South Africa: around 500,000 vehicles are built there, although half of this figure is made up by the commercial segment.

… AND NOW THERE ARE SWEET-AND-SOUR NOODLES EVERYWHERE.

The opportunities in Africa have not escaped the notice of Chinese OEMs, who have started wholesale initiatives to establish themselves in the attractive African market. A particular success factor for Chinese manufacturers’ market entries is a pronounced willingness to experiment, with their habit of developing business models using trial-and-error forming a cornerstone of their increasing market share in Africa.

Figure 3a: Chinese OEM activity in Africa, (data source: polariXpartner)

As becomes clear from the visualization above, the Chinese have invested simultaneously in a broad and diverse range of partnership experiments to import, manufacture, and sell vehicles across the entire continent. Their market entry is based on small joint ventures with differences in which modules are exported from China to Africa; their presence is secured by setting up servicing and sales structures, and in a move straight out of the global expansion text book, Chinese manufacturers aim to establish one strong brand and to gradually put their own structures in place. This is a long-term strategy and the Chinese are willing to finance it with very low margins in the early phases.

GEELY	DONGFENG DONGFENG MOTOR CORPORATION	长安汽车 CHANGAN	CHERY	比亚迪汽车 BYD AUTO
• Export to Africa: 30,897 units ('11) • SKD assembly operated by local partner in Ethiopia • Own plant in Egypt with annual capacity of 30,000 units (partner GB Auto) and projected capacity of 50,000 units	• Venture with the local partner selling commercial vehicles in South Africa • Focus on commercial vehicles for the African market • Planning an own car assembly in South Africa • operates small assembly plant with Nissan in Angola	• South Africa import partnership collapsed in 2012 • Assembly plant in Nigeria with annual capacity of 10,000 units	• Local partner assembling separate brand Speranza - shut down • Plans 50 million US$ assembly plant in Kenya	• Assembly in Egypt by local automaker • Plans assembly line with annual capacity of 7,000 units in Ethiopia with partner • small assembly factory in Sudan
FAW	Great Wall	FOTON	LIFAN MOTORS	吉奥汽车 GONOW
• Assembly plant in Ethiopia with annual capacity of 2,000 units • Building a 20 million US$ assembly plant in Kenya • Building a truck-assembly plant in South Africa • Plans to build a passenger car-assembly plant in South Africa	• Export to Africa: 25,000 units ('13) • knock-down factories in Egypt, Ethiopia, and Nigeria • Re-export of cars to neighboring countries	• Export to Africa: 10,000 units ('13) • Plans 50 million US$ assembly plant in Kenya with annual capacity of 10,000 units	• Local partner assembling separate brand Abay in Ethiopia - shut down • Changed approach to assembly plant for own brand in Ethiopia	• Export to Africa: 3,600 units ('08) • SKD plant in Egypt • African market: 30% of total exports

We do not expect the Chinese "Africa laboratory" to start churning out break-through, global paradigm-changing concepts any time soon, though: a productive industrial base for growth requires by its very nature a continuous and broad range of measures, with Africa still lacking comprehensive chunks of technology, investment capital, and expertise in order to keep the industrial expansion momentum going; in addition, the political and legal frameworks need to continue supporting economic growth. Yet their attempts are giving the Chinese companies more confidence in their own abilities, confidence which will be necessary to become competitors in other markets.

Regardless of the above, no one can afford to omit Africa from internationalisation and expansion strategies any longer: the odds are no worse than when in investing in other emerging markets. The future will be best confronted by creating individual catalogues of measures to implement stable business models for this new and still unexplored market: this will include expanding local supply chains and in-country production sites, as well as extended sales networks. Both manufacturers and suppliers are advised to systematically observe the situation on the ground and make targeted efforts to take part in the growth.

IF YOU WOULD LIKE MORE INFORMATION ABOUT OUR MARKETS AND STRATEGY SERVICE OFFERING, PLEASE USE THE FOLLOWING LINK: POLARIXPARTNER MARKET & STRATEGY

4| NECESSITY FOR SUCCESS ACROSS THE AUTOMOTIVE DIASPORA

Decisions taken in the BRIC countries were by no means made in a vacuum: driven by "what was happening in the market" (read: what everyone else was doing), the strategies across OEMs and manufacturers bore a clear resemblance to one another, with the only differences being the point of time for market entry and the ensuing readiness or ability to keep investing and integrate local suppliers.

ENTREPRENEURSHIP INSTEAD OF COLONISATION

However, these off-the-peg market-entry blueprints will not be so easy to apply to the new countries, which are too varied and feature to many incomparable differences in local production environments, This will render attemps to make a success of local markets far more complex from a business point of view, posing a tremendous challenge to the spirit of entrepreneurship in each company looking to invest. While the major difficulty to date was transferring production models to new locations, the task in conquering the new markets mentioned above will consist in no less than creating new business models from scratch and integrating local suppliers as well as potential competitors, all the while producing in far smaller volumes to a range of highly varied technical standards.

During the BRIC investment phase, the macroscopic market data (economic growth, GDP, total sales, investments in transport infrastructure) offered a solid basis on which the producers could succeed – or indeed fail. In BRICs, it was entirely possible to hide behind "bold" investments, while the smaller countries will require more local knowledge, greater investment flexibility, increasingly supple business models, and better networking. Entrepreneurial instinct will play a far more important role, while a much greater degree of the costs and investment structures down the entire value chain as well of both the investor's own and core competitors' figures will be necessary in order to enable continuous, rapid local adaptations.

MEASURING COSTS BY LOCAL STANDARDS

A frequent error is applying "global standards" when erecting a local investment model, because our experience is that costs such as building investments, reasonable packaging regulations (due to lower overall quality requirements), or life-spans and depreciation cyles vary widely from project to project.

The ability to accurately value costs that can be expected is more than just pulling out the same old spreadsheets that were used elsewhere: after all, in most cases, even the costs for the manufacturer's own section of the value creation chain in countries in which it is firmly established are not documented robustly enough. We have come to the conclusion that this is not a controlling problem, but an issue which is principally due to the following factors: a lack of understanding in each company area for their own cost factors; poor handling of the complexitites arising from a range of vehicle versions; discontinuing the shift of make-or-buy packages; or things getting lost in the "Chinese whisper" communications between operative business decisions and commercial evaluation of the data.

In situations in which the business case is highly sensitive vis-à-vis the investment (i.e. because only low production runs are ex[ected or scaling is limited by volumes down the line), a perfect knowledge of real cost factors in-country is indispensable. Unfortunately, internal planners are not infrequently resistant to this transparency as they plan from the standards they are used to – and have themselves established in their countries of origin; they may be unwilling to investigate conditions in other regions, and this usually makes localisation far more expensive than the in-country organisation needs it to be.

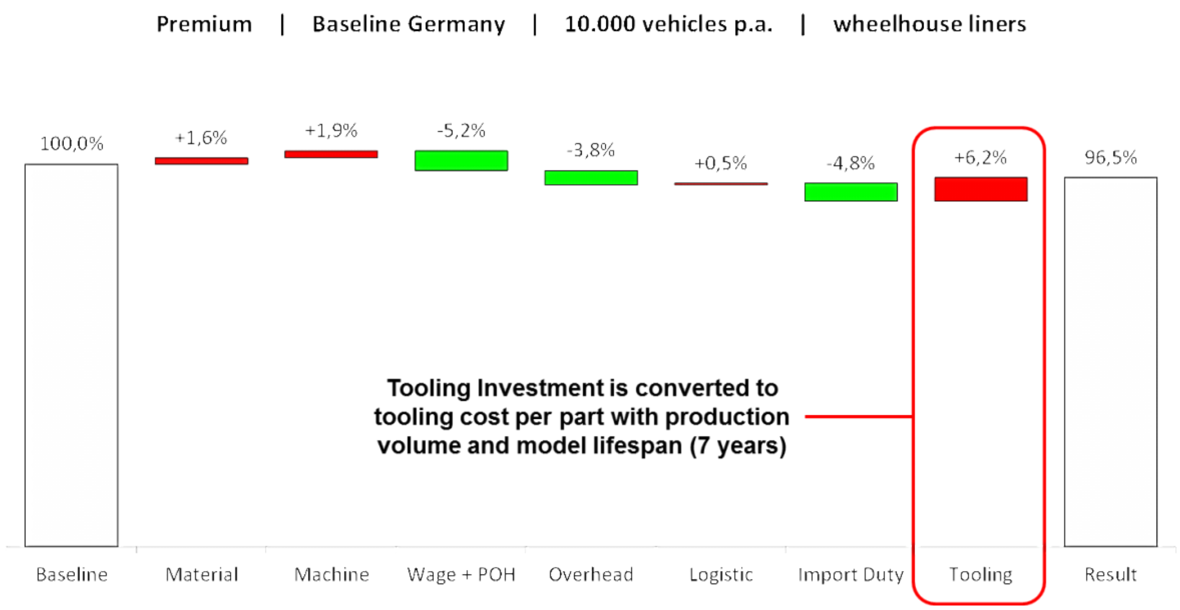

Figure 4: Modelling the costs structure for a CKD export vehicle from Germany to be assembled in Eurasia

In the example shown in figure 4, the task was to include local tool costs in the plan as local best practices in such a way as to best use the standards and life-spans required in-country. This made it crucial to include in the equation the actual costs which could be expected to be incurred, instead of simply working with estimates.

IF YOU WOULD LIKE MORE INFORMATION ABOUT OUR POLARIXCOSTING SERVICE, PLEASE USE THE FOLLOWING LINK: POLARIXCOSTING

5| TARGET COSTING: REFERRING TO REALITY IN THE PLAN.

As well as failing to take local best practices into account, many investors work on a “cost plus” basis – and do so for a simple reason: while investment projects abroad are generally initiated by top management, middle management will very frequently be unwilling to throw their weight behind them.

This is not a matter of deliberate or disruptive sabotage, but generally due to the fact that those below the top echelons who will be left with implementing the new project are already working at, or close to, capacity in their domestic roles: this makes them inclined to plan projects “with risk margins" which can be used to protect their lean (or perhaps rather flabbier) organisational units from what they see as "expeditions" with uncertain outcomes. This adds an overly security-orientated mode of thought at home to the lack of knowledge with regards to local best practices abroad, resulting in costings for projects abroad which come loaded with a complement of colourful planning costs, IT infrastructure investments, or quality requirements heavy enough to sink the ship before it gets out of port.

This is another situation in which it can be helpful to take a look at competitors: usually, there will be at least one manufacturer doing good business in the target country despite all of the difficulties incurrent in doing so. The aim must then be to identify these successful ventures and to give internal areas clear orientation towards them by establishing the competitor's performance in every dimension as a set of benchmarks. If this is retrofitted into the organisation and consistently implemented, it can turn risk-avoidance target costing results into a roadmap for improving the areas in which the distance to the competitor is greatest..

The following diagram shows a schematic analysis which reveals how a vehicle built in China for export CKD assembly in South America is costed. This analysis takes into account all aspects of the value creation chain at various levels and applies models to simulate currency effects and changes in distribution or margin structure. The surprising insight from this diagram is that it was viable to export a vehicle even from China in spite of the disadvantages of running joint ventures there.

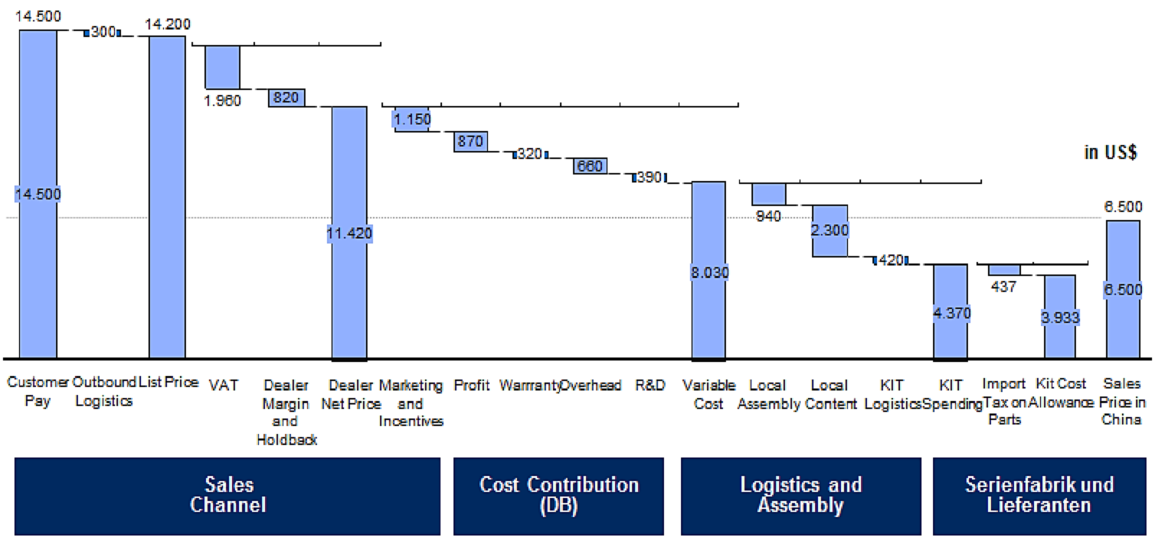

Figure 5: Modelling the costs structure of a vehicle Modelling the costs structure of a vehicle for export from China an CKD assembly in a South American country

YOUR BENEFIT WITH POLARIXPARTNER

The crucial take-home from this approach is that costs must be strictly derived from the real world and applied to the plan (not the other way round). This leads to planning from the perspective of the in-country supply chain and the local customers down the line and applying this to the manufacture. These figures will be taken from actual on-the-ground conditions and actual values are not compared to targets in an abstract plan, but to the values achieved by the best competitor.

This means that the overriding question during implementation should not be “what was wrong with the plan?” We are seeing an increase in planner-bashing with regard to schemes that no-one believed in any more anyway because they were too optimistic, too generic, or too something-or-other; clearly the better question to be asking is “what is the actual distance between us an the best competitor at each stage of the process – and how can we shorten it?”

Whether you are a supplier, an OEM, or a local partner, POLARIXPARTNER’s experienced consultants would be delighted to enter into an intensive, committed discussion of the business model you want to apply or the expansion strategy you are looking to implement. We enjoy playing the “sparring partner” if you want to test your plans in the ring, and are looking forward to hearing from you.

THE GUIDING STAR FOR THE
MANUFACTURING INDUSTRY

AUTHOR & YOUR EXPERIENCED CONTACT AT POLARIXPARTNER

Dr. Engelbert Wimmer – Managing Director and Partner

- More than 15 years' experience as a consultant in the manufacturing industry – especially the car industry.
- Profound understanding of processes in product development and sales & distribution, globalisation of R&D, manufacturing footprint, organisational development and change management, as well as IT management.
- Published author, popular professional speaker

DR. ENGELBERT WIMMER

POLARIXPARTNER GmbH
Graf-Siegfried-Str. 32, 54439 Saarburg, Germany
www.polarixpartner.com

Tel. +49 6581 8290-212
Mobil +49 151 52742512
Fax +49 6581 8290 100
E-Mail Engelbert.Wimmer@polarixpartner.com

ABOUT POLARIXPARTNER.

MANAGEMENT. CONSULTANCY. IMPLEMENTATION. polariXpartner is the management consultancy for the manufacturing industry. As industry insiders with many years of experience, we guide you on your way to success, just as the North Star, Polaris, has offered generations of seafarers orientation. Our approach is holistic, our philosophy focussed on implementation: we analyse and strategically evaluate your core processes while remaining active on your shop floor to make sure that optimal improvements are implemented up and down your value creation chain. **THINKING AHEAD. OPTIMISING. IMPLEMENTING.**