

A market on the move

Competition and emerging market demand
growth in automotive



Building a better
working world

With growing economies, a growing middle class and low vehicle penetration rates, emerging markets are the key source of growth for today's global automotive industry. China, Brazil and India are just three new markets critical to, and fueling, this growth.

Emerging market demand growth¹ is ranked third in a recent global study by EY called *Business Pulse: exploring the dual perspectives on the top 10 risks and opportunities in 2013 and beyond*. We examine this opportunity within the automotive sector and its impact on competition.

Automotive

Self-assessment questions

1. If your company is based in an emerging market, how do you plan to compete with Fortune Global 500 players that are also targeting these markets?
2. Which strategies do you have in place for dealing with market instabilities, government policies, regulations and environment?
3. How do you adapt and adjust to your customers right now? Do you have a scenario(s) in place for the next five years?
4. How do you balance between producing new and innovative design globally and the need to be flexible to meet local demands?
5. How do you use new technologies in your product development and for customization?
6. Do you have the right talent, cultural understanding, age profile, experience and skills to create credibility and relationships with critical stakeholders (e.g., regulators, company officials and key business leaders) in your most important emerging markets?

Wealth of opportunity

In the US today, there are approximately 800 cars for every 1,000 people. In China there are 50 and in India there are less than 20. These figures are a shining invitation to automotive companies to grasp the opportunity to move into these markets and boost the ratio – and their revenues.

Steve Patton, EY Principal and Automotive Advisory Services Leader, says the industry is primed for these rapid-growth markets (RGMs) including China, India, Brazil, Africa and parts of Eastern Europe. "You can't help but look at those markets and see an opportunity for these auto companies to make significant investment and capitalize on that growing market. I don't know if it's a five-year growth pattern or as long as a 50-year growth pattern, but it's clearly going to be significant."

"Despite already holding the title of the largest automotive market in the world, China still has a wealth of opportunities," says Peter Mao, EY Partner, Automotive Advisory Leader, China. The recent slowdown to single figure year-on-year growth in China has caused some nervousness in the sector, but Mao says this is simply a "temporary readjustment" providing the opportunity for more steady long-term growth. This growth will be driven by a focus on the more underdeveloped regions of China, diversification of customer demands, more investment in R&D, increased opportunity for collaboration and development of aftercare services.

In Brazil, the industry is maturing, with representatives of 45 different brands, 2,000 models and almost 4,000 dealers making it the fourth-largest automotive market in the world. And growth is not slowing any time soon.

Likewise in India, the medium-to long-term growth prospect is far from abating, despite a slowdown in 2013. According to Rakesh Batra, EY National Leader Automotive Sector, India is poised to surpass Brazil for third place in the global passenger vehicle market. "In motorcycles, it's the second-largest market today; in commercial vehicles, it's the fourth-largest," he says. "In the next 10 years, based on India's economic growth, it is expected to be the third-largest producer. That's the primary opportunity in India."

More spend from an emerging middle class and increasing infrastructure build is enabling this potential automotive sales boom. Already, two-thirds of global consumer spending comes from RGMs, according to EY's *Business Pulse* study. And the middle class in developing countries is growing fast, with the number of RGM households earning above US\$30,000 expected to more than double to 149 million by 2020, overtaking both the US (120 million) and the Eurozone (116 million).

Already, Brazil's middle class has grown to 52% of the total population over the past 10 years, and in China, according to official government analysis by China Market Research Group, the "middle class" Chinese consumers consider themselves on their way to riches, despite the slowing economy. Their salaries have been rising in double digits or more for the past decade. According to EY's 2013 report *Hitting the sweet spot: the growth of the middle class in emerging markets*, India's middle class, at around 50 million people, or 5% of the population, is expected to grow to 200 million by 2020. This new money will create new demands and, in automotive sector, result in large numbers of first-time buyers, who seek to fulfil their aspirations of owning a vehicle to meet the personal mobility needs and as a status symbol.

In Brazil, there is an added incentive from the Government's tax breaks to automotive companies that invest in science, technology and fuel efficiency. This incentive is giving Brazil a unique position within the industry, says Rene Martinez, EY Partner – Brazil Automotive Leader.

Competing in a fragmented market

To be competitive in these RGMs, companies need a firm grasp of consumer needs. A one-size-fits-all approach of bringing in best-selling products from other markets will not do.

Mao has studied the origin of cars being sold in China. While Chinese car makers have the largest share at just over 40%, the rest of the market share is very competitive. German car makers represent 19%, Japanese 14% and the US about 12%. "It's very competitive in China versus some other markets," he says. Last year, China sold 15 million units for the passenger vehicle category, versus 3 million for India and less than 4 million for Brazil. "Broadly speaking, it doesn't matter which market you're talking about, they should follow similar development paths – from

¹ Naming of the opportunity for the survey.

² The World Bank.



focusing on new car sales, to after-markets including after-sales services and offering financing and leasing products. But right now, it's the speed of development, market size, level of competition and also cost segments that are different in China from other emerging markets."

By contrast, Patton envisages less demand for the bigger vehicles that are popular in the US, and more interest in fuel efficiency and cost. "You go into these emerging markets and horsepower probably isn't even going to be in the vocabulary of a potential buyer. They'll be more interested in fuel efficiency, cost and high content – but not luxury or extensive content." The RGM buyer may still want some kind of in-vehicle entertainment or navigation, however, and companies need to figure out how to provide those modifications at a lower cost than currently offered in mature markets.

In China, the middle class is patriotic in its purchases and prioritizes practicality, while the upper class buys luxury cars for status. "I think the way you compete is to enhance the triangulation of all those things: what's the price, what's the fuel efficiency and what's the content? I think that's probably what wins in the showroom," says Patton.

Batra outlines that the automotive sector in India comprises two distinct markets: urban and rural. As the growing middle class and investments in infrastructure will see growing urbanization and an expansion of this market, the rural customer must also be taken into account. "India is a very different market and they're also cost conscious, not just of upfront vehicle costs, but also operating costs, fuel efficiency and maintenance costs," he says. "The urban and the rural are very distinct markets, and you need to have different strategies for how you will sell and support vehicles in each of them."

While Indian customers are cost conscious, Brazilian customers are safety and environmentally conscious – and all RGM customers expect more. "Customers expect a lot more connectedness – being able to have bluetooth capability, GPS and live updates of traffic conditions," says Martinez.

A challenge to delivering these growing demands is infrastructure: not all RGMs have paved roads, so dirt-road vehicles need to be offered, and not all have high-speed internet connectivity. "Some of these countries couldn't sustain that number of cars today even if the wealth was there to buy them. But as the infrastructure is built, it will make it more plausible to have more vehicles on roads, particularly in India," says Patton.

Think global, act local

The International Monetary Fund (IMF) expects growth of 5%-6% across RGMs in 2013-14, far ahead of mature economies. While growth percentages are high in RGMs, making them attractive for investment, the overall volume is often still below that of mature markets. Margins are unlikely to be high initially, and companies need to protect their mature markets while investing in RGMs. Companies can then subsidize R&D spend and enter emerging markets at a low, or potentially negative, margin.

To build margins, the challenge is to understand transparency in business practices, the needs of the local market and how to modify existing products to meet these needs. So, while opportunities are there for the taking, companies must do their homework first. Companies such as Ford and General Motors have already done theirs and are staking out where they aim to sell.

"They're already starting to stake their ground, but I think the local competition will be very formidable – there seems to be a stronger sense

BMW in China: listening to consumer technology demands

Responding to consumer demand for in-vehicle technology and connectivity, BMW teamed with local Chinese mobile operator China Unicom to develop ConnectedDrive services dedicated to the Chinese market. Since September 2012, new BMW 5 and 7 Series cars in China have included an embedded cellular communication module, enabling drivers to access information services on the dashboard display or via a call to a dedicated 24/7 concierge service, which can be reached by pressing a menu selection via the iDrive controller in the car.

China Unicom 2G and 3G networks deliver data services, including traffic information for 14 major Chinese cities, on a navigation system with 3D maps, with the ability to calculate an alternative route if the traffic jam is likely to exceed five minutes. ConnectedDrive also links to roadside assistance or emergency assistance in case of breakdown or accident.

The population of China is increasingly accustomed to being connected wherever they are. BMW estimates there are 388 million mobile internet users in China, many with smartphones. BMW drivers can use a dedicated smartphone app or contact the BMW ConnectedDrive call center to unlock the car door, blow the horn, flash the lights or locate a missing or stolen vehicle.

BMW has been growing at a rate faster than Mercedes in China for the past two years, with predictions that the Chinese market will surpass the US as the largest single market for 2013. The group's deliveries increased by 35% to 34,166 units in August 2013, while Audi and Mercedes posted gains of 23% and 27% respectively. The three German luxury car manufacturers, all with plants in China, have quadrupled their local production over the past five years and, today, account for about 75% of premium cars sold in the market, according to LMC Automotive data.

BMW is in negotiations with the Chinese Government for approval to start the third phase of their assembly plant in Shenyang, northeast China, to boost its production capacity to 400,000 vehicles.

of nationalistic pride in some of these emerging markets than there is in others. I think the competition is going to be extremely strong. And it already is," says Patton.

Essentially, it's all about the products, Patton says. "It's trying to figure out if you can bring a product with the right combination of features for the right price and, if a company can do that, then I think you've got a good chance to sell it."

GM, Ford and Volkswagen are already making headway in emerging markets, with some success. Some are moving operations to the markets they hope to conquer, supporting local markets and employing local workers to evoke an element of national pride in the product. "It's probably a combination of feature, cost and configuration that doesn't exist anywhere else that will make you successful," Patton says.

In India, product strategy and the viability and sustainability of the dealer and distribution networks are key. "The return on investment and profitability also takes a long time in India – longer than other markets, so they need to be prepared for that," Batra warns. "India is a difficult market, but it is a large market."

In all RGMs, companies will need local leadership, of nationals not expats, and to hit these markets with a different product set. "Companies will need to have an understanding of three things: local business practice, local resource and configuration product content," Patton says, "They will need to have a really good understanding of how they're going to attack in each of those before jumping in."

Download the full *Business Pulse* report on the global top 10 risks and opportunities in 2013 and beyond:
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