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Delivering results

Key findings in the Automotive industry

15th Annual Global CEO Survey

Sector summary

pwc

Commitments to doing more business globally are accelerating in 2012 despite economic, regulatory and other uncertainties. CEOs tell us they see the fundamentals for future growth still squarely in place.

To understand how businesses are preparing for growth in their priority markets, we surveyed 1,258 CEOs based in 60 different countries and talked to a further 38 CEOs face-to-face for our 15th Annual Global CEO Survey. *Delivering results: Growth and value in a volatile world* explores CEOs' confidence in prospects, and how they are building local capabilities and creating new networks for new markets.

CEOs are adapting how they go to market, reconfiguring processes and at times entire operating models. They are also addressing risks that greater integration can amplify and are focused on making talent more strategic to pursue market opportunities.

This report looks at the key findings in the automotive sector, based on interviews with 104 automotive CEOs in 31 countries, as well as an in-depth interviews with Caterpillar Inc. Chairman and CEO Douglas R. Oberhelman and Bharat Forge Ltd Chairman and Managing Director Baba N. Kalyani. We spoke with CEOs from companies across the automotive value chain, predominantly suppliers, as well as automotive retail companies. To explore the full results of the 15th Annual Global CEO Survey, please visit www.pwc.com/ceosurvey.

Introduction

CEOs in every industry are currently redefining the way they go to market, as they wrestle with a volatile global economy and the problems in the euro zone. For automotive CEOs, the challenges are particularly acute. Many automotive companies already operate on a global basis, and many of those that don't are gearing up to do so. They're particularly keen to expand their footprint in the emerging economies, where the potential for growth looks most promising. That means they must be able to accommodate local preferences and requirements and react rapidly to changing local conditions and regulations.

It's not something Original Equipment Manufacturers (OEMs) can do alone. It's a tough job that requires collaboration across the whole supply chain and entails striking a very careful balance. Automotive CEOs have to think globally, when it comes to strategy, branding, products and platforms. At the same time, they have to let the different divisions of the business act locally in tailoring vehicles for different markets.

Global automotive companies are also particularly vulnerable to local risks that can become global disruptions, given the complicated supply chains on which they rely. Recent events in Japan and Thailand clearly show that the industry still has work to do on that front.

How will all these things get done? Attracting and keeping the right talent is the first and, arguably, most important step. Skilled production workers and high-potential middle managers (especially the skilled engineers who are so critical to innovation) are in high demand. Staffing offices and plants in key locations like China is tough, too. But getting it wrong hurts both the bottom line and the development pipeline. In fact, Caterpillar Chairman and CEO Douglas R. Oberhelman tells us talent is his number-one priority. We think better information on a wide range of human resources (HR) measures is a critical part of the solution.

Confidence disrupted

As 2012 starts, the outlook is more uncertain than ever. Just 21% of automotive CEOs believe the global economy will improve over the next 12 months. A full 80% are worried about the prospect of volatile economic growth, and 76% are concerned about lack of stability in the capital markets (which is significantly more than the overall average of 64%). So it's hardly surprising that automotive CEOs are feeling less optimistic than they were last year.

Even so, many automotive CEOs are still willing to invest in the right areas, whether that's entering new markets, developing the next generation of vehicles or finding and training good people. More than half of all automotive CEOs plan to alter the amount of capital they're investing, or change the way they're investing it, over the next 12 months.

Just what sort of changes they mean depends on the company. Some companies may be tempted to conserve cash by cutting people and capacity—which is often a valid response to economic uncertainty. But it's important not to cut back at the expense of future growth. A number of North American automotive companies reduced their investment in R&D during the worst of the recession, for example, and then found they didn't have the right products on offer when demand increased.

Getting the right financing may be a challenge, too, especially for smaller suppliers: 43% of automotive CEOs worry that they won't be able to finance their growth plans. That may reflect tougher access to capital in the euro zone in particular.

Europe holding steady so far, but CEOs are worried

Western Europe is traditionally an automotive stronghold, so concerns about the impact of the sovereign debt crisis on demand for new vehicles are weighing heavily: 57% of automotive CEOs say their companies have been directly affected by the crisis. They're also worried about the future of the currency itself. Indeed, they're more anxious about currency fluctuations than their peers in other sectors: 76% see reason for caution—and 32% are 'extremely' concerned, compared to just 23% of the overall sample.

That said, the news isn't all bad. The effect of the sovereign debt crisis has been less severe than expected so far.[1] Demand in the five most embattled countries is weak and falling, but elsewhere sales have proved durable, with strong growth in Finland, the Netherlands and Switzerland as well as moderate growth in Germany, Norway and Sweden.

What's next? Sales in the European Union are expected to drop by 4.5% in 2012. But if the debt crisis drags on, sales could be harder hit—particularly in France, where debt levels and a downgrading of the country's credit rating aren't the only concerns. The market is still working out the after effects of the scrappage scheme that was in place in 2009 and 2010, and bonuses for low-emitting vehicles are being scaled back. The tax on company vehicles is also going up.

Cutting costs through innovation, global platforms

Automotive companies are keeping up the pressure on costs and becoming more efficient. More than four-fifths of automotive CEOs say they've implemented a cost-reduction initiative over the past 12 months. Nearly as many (69%) plan to cut costs further in the next 12 months. That doesn't necessarily mean reducing the headcount, though: 72% intend to focus more heavily on innovating to improve existing processes.

For example, most OEMs are relying more extensively on global platforms. In 2000, the top 20 platforms accounted for roughly 35% of global light vehicle assembly.[2] In 2012, they're expected to account for about 45% of assembly, even with an additional 26 million units of forecast global production—a trend that will no doubt continue. For the suppliers who make up the largest part of our sample, these changes are both a risk and an opportunity. Consolidated volumes mean fewer suppliers, but the winners can achieve better economies of scale and global contracts. Both OEMs and their suppliers will need to be careful, though. OEMs can't afford to rely too heavily on just a few suppliers, if they want to make sure their supply chains are resilient. And suppliers will probably be cautious about investing too much in serving one OEM, too.

1 PwC, 'Autofacts: EU Debt Crisis Outlook: In need of a New Year's resolution' (December 2011).

2 Autofacts analysis

Revving up local production in Brazil

In September 2011, the Brazilian government announced a new policy, Federal Decree number 7567. It's designed to reduce demand for imports, encourage local manufacturing and stimulate export growth in the automotive industry.[3] The headline change is a 30 percentage point increase across the board in Federal Excise Tax (IPI) rates on vehicles. While that applies to domestic and foreign producers alike, vehicles manufactured locally (i.e., in Brazil, Mexico or trading partners in the Southern Common Market) benefit from other tax reductions that offset the hike. The requirements include 65% local content, a commitment to local R&D, and the onshoring of six out of 11 production processes outlined in the decree. Altogether, vehicle prices could go up by 25-28% for those that don't meet the conditions. That's expected to hit Chinese manufacturers—which have managed to capture 3.3% of the market in just one year—particularly hard.

Making it happen

So automotive CEOs are now focusing on the upside as much as the downside. They're preparing their companies to cope with a world where the risks and opportunities are increasingly interconnected but the sources of growth are often local. This presents three related challenges:

- Reconfiguring their operations to meet local market needs
- Defending against micro risks and macro disruptions
- Getting and keeping the right talent

Balancing global capabilities and local opportunities

The automotive sector was one of the first industries to produce truly global businesses. Our sample itself reflects that spread. About half the automotive CEOs we surveyed run companies with key operations in Western Europe and North America. Roughly the same number run companies with key operations in Latin America and East Asia.

But globalisation has never been without risk. The automotive sector was one of the worst hit in 2008, when the financial crisis made the downside of closer economic integration all too clear. Questions still continue as new regulations and restrictions are put in place. In many countries, the industry is considered 'too big to fail'—because it employs so many people, both directly and indirectly, and governments don't want to see those jobs lost.

Indeed, several countries are now introducing new tariffs or tax increases specifically to promote their domestic automotive industries. Brazil is one example (see sidebar, *Revving up local production in Brazil*). Argentina is also pushing carmakers to export as much as they import.[4] And, in China, the National Development and Reform Commission (NDRC) will no longer promote foreign investment in traditional automotive manufacturing, with effect from January 2012.[5]

These aren't the only instances of a government changing the rules to support local industry. Russia's Decree 166, which came into force on February 2011, lifted the bar for OEMs hoping to benefit from reduced tariffs on companies with a local assembly presence.[6] While the old rules required local production of 25,000 units per year to get tax breaks, the new rules have upped the number to 300,000 units of new production or 350,000 units of modernised production. There are other changes, too, including requirements for locally-produced engines and local research and development (R&D). So it's little wonder that nearly half of all automotive CEOs (47%) are concerned about government protectionism, particularly given the importance of these regions to overall growth.

3 Autofacts, 'Policy changes for Brazil's auto sector' (October 2011).

4 Christian Oliver and Jude Webber, 'Argentina to import S Korea cars for peanuts', Financial Times (17 June 2011), http://www.ft.com/intl/cms/s/0/831ad92a-9901-11e0-acd2-00144feab49a.html#axzz1kH1kYrUw

5 'Xinhua: New Chinese car rules won't affect foreign automakers', Global Automotive Business (3 January 2011), http://www.globalauto.biz/2012/01/xinhua-new-china-car-rules-wont-affect-foreign-automakers/

6 PwC, 'New industrial assembly rules: February 2011'.

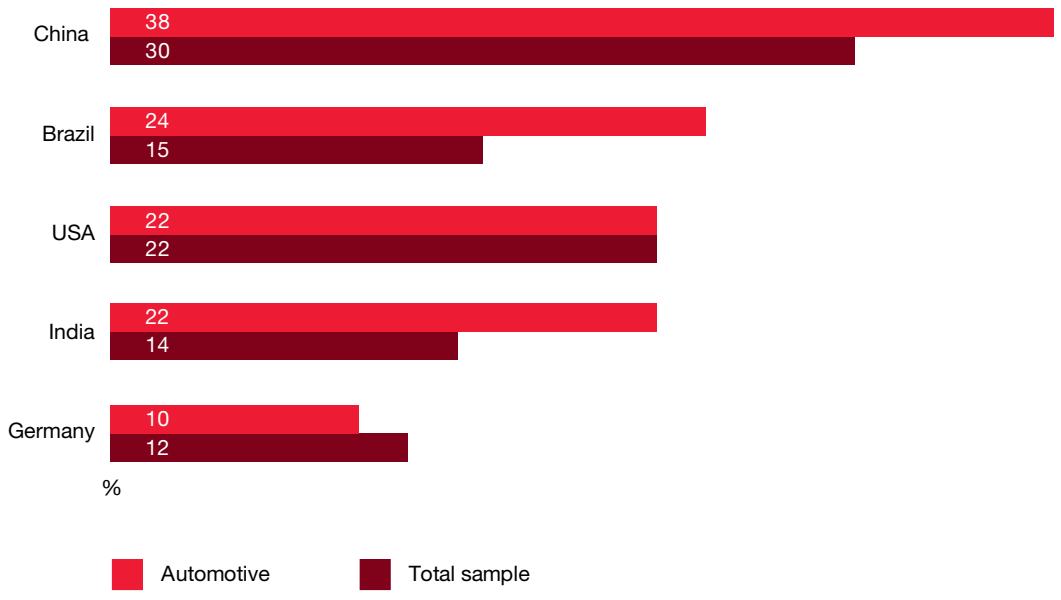
China is the top automotive growth region

Many automotive CEOs are placing their bets on fast-growing economies. We asked them which three markets (outside their home country) they regard as most important for future growth. China comes first, but Brazil and India are also high on the list (see Figure 1). Local suppliers are upbeat about the Indian's market's prospects; Mr. Baba N. Kalyani, Chairman and Managing Director of Bharat Forge Ltd., a forging company in India, says, "For us, automotives is the base business—but it's also a mega trend in India. My estimate is that in the next 10 years, it will grow to three times the size it is today".

The US remains important: 22% of automotive CEOs still see it as one of their top three markets. But Europe lags far behind: only 10% of automotive CEOs favour Germany, and only 3% name France.

Figure 1: China tops the list of key markets for automotive CEOs

Q: Which three countries, excluding the country in which you are based, do you consider most important for your overall growth prospects over the next 12 months?



Base: All respondents (Total sample, 1258; Automotive, 104).
Source: PwC 15th Annual Global CEO Survey.

Why is China so important to so many automotive CEOs? Two key considerations: customers and factories. The world's most populous country is also the biggest automotive market and assembly location. The dramatic growth levels of 2009 and 2010 may have slowed in 2011, but the outlook is still strong. Indeed, Autofacts forecasts that China will produce 28 million units a year by 2018, compared with just 11.1 million units in the US and 6.4 million units in Germany.

For forward-looking automotive CEOs, another good reason to be in China is to size up and monitor the future competition. The domestic Chinese automotive industry is very fragmented. That's currently putting the brakes on efficiency and slowing down China's efforts to become globally competitive. But Beijing clearly aims to strengthen the domestic players as part of the process of 'industrial integration'. The new NDRC policies are a good example. The government wants to encourage foreign investment in other strategic sectors like alternative energy, advanced materials and new energy vehicles, rather than in automotive production.

Back in 2009, the Chinese government stated its intentions to consolidate the industry into a group of 10 top automakers, organised into 2 tiers.[7] The plan named 8 out of the 10 groups it plans to support. As domestic automakers get stronger, they are likely to take a bigger share of the Chinese market, especially as interior and rural China become key drivers of growth. Farther down the road, they may start to compete in other markets too.

Customising cars for the Chinese market

Nearly half of respondents say their company modifies its products and services to accommodate the Chinese market. For automotive CEOs the percentage jumps to 59%. That's not surprising. Automotive companies have already developed strategies to make sure their products meet varied regulatory requirements. And they're actively tailoring vehicles to local consumer preferences, too.

The premium segment is one good example. In 2010, China already made up 13% of premium vehicle sales globally.[8] And yet only 6% of Chinese drivers currently buy premium vehicles.[9] That compares to 12% in the US and 18% in the EU, so there's huge potential for revenue growth.[10] With traditional markets declining, premium automakers are targeting China by tailoring vehicles as much as possible to the needs and preferences of local consumers.

What about designing products specifically for a local market? With economies of scale so important for cost structures in the industry, it's generally more practical to tailor products locally, rather than design from scratch. Only 19% of the automotive CEOs who see China as a key market are developing products and services specifically for the local market. Whether their vehicles are customised or designed locally, though, automakers will need to work hard to market them. There's been a huge surge in the variety of designs on offer, so standing out from the crowd is a major challenge.

7 "Automotive Industry Readjustment and Revitalization Plan" - Issued by China's Ministry of Industry and Information Technology

8 Autofacts analysis and publically available OEM annual reports

9, 10 PwC, 'Automobilindustrie und Mobilität in China: Plan,-Wunsch und Realität' (2011).

Right now, China's automotive consumer base mostly comprises the urban populace from large metros along coastal China. But this will change dramatically, as economic development spreads inland. Over the next few years, consumers from interior China and from Tier 2 and Tier 3 cities will account for a larger share of the local market. So the industry will need to adapt its product mix and distribution networks accordingly.

In light of the NDRC's recent policy change; foreign automakers looking to build new factories in China's interior will now face a more stringent approval process. Of course, it was always necessary to establish a robust joint venture with a domestic company to succeed in China, but such partnerships will now be even more important.

> ***"We have to listen to local markets and customers, and we have talented engineers from many countries who help us innovate. That makes us a stronger and a better product innovator."***
>
> **Douglas R. Oberhelman**
> Chairman and CEO,
> Caterpillar Inc.

New products driving growth

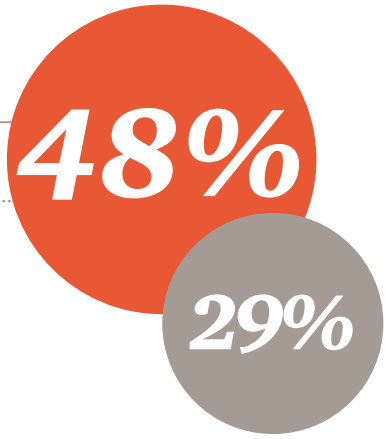
Strong product development is at the heart of the automotive industry. That's not just true for OEMs. Suppliers play a big role in developing new components and systems to provide better safety, fuel economy, infotainment and the like. So it's not surprising that 29% of automotive CEOs see new products and services as their primary route to growth this year.

Some of these new products are a radical departure from older designs. Alternative fuel vehicles not only use a new kind of engine, for example; they also require a completely new infrastructure. That means the industry needs to cooperate with government and other sectors like utilities to provide charging stations for electric vehicles. It may also have to adopt new strategies, like developing urban mobility schemes in conjunction with a range of upstream and downstream partners. Half of automotive CEOs say they're increasing the emphasis on innovating new business models.

Vehicle electrification isn't the only thing the automotive industry has to consider. Regulations on fuel efficiency mean that traditional vehicles need to improve as well, in order to meet stricter standards. That's putting a lot of pressure on the innovation process, as automakers and suppliers must drive innovation simultaneously in several different areas.

While many automotive companies already have significant R&D and innovation capacity, they're not sitting still. Some 78% of automotive CEOs plan to change their R&D and innovation capacity in 2012—and 28% of them plan to make 'major' changes. Most will be increasing, rather than cutting, their investments.

Nearly half of automotive CEOs surveyed were directly impacted by the events in Japan, far more than across the overall sample



Resilience to macro disruptions and micro risks

In 2011, global businesses had to confront a portfolio of unrelated high-impact global risks—from political upheavals to massive floods and a sovereign debt crisis. The earthquake, tsunami and resulting destruction of the Fukishima nuclear plant in Japan had particularly far-reaching consequences for the automotive sector. Nearly half the automotive CEOs (48%) we surveyed say it's had a direct financial impact on their companies. That's almost 20 percentage points more than the overall average. The Japanese automakers obviously suffered most; it's no secret that several hundred thousand units of production were lost as a result of plant closures and component shortages. But they certainly weren't alone.

The north-eastern region where the explosion took place has only been an automotive manufacturing centre in recent years. Ironically, it was established to decentralise production, thereby reducing the chance that a natural disaster might destroy all Japan's manufacturing operations.[11] But despite this strategy of spreading risk, the automotive supply chain was severely disrupted. That's partly because, with such an intricate and integrated supply chain, an interruption in the supply of seemingly insignificant parts can affect operations across the globe. For example, the temporary shutdown of a paint pigment plant in the region—the sole source of a particular pigment—caused worldwide production scheduling problems.

The good news? Japan's automakers bounced back must faster than anyone expected. Their assembly output was severely depressed from March to May 2011, but they were all operating at pre-crisis levels again by the end of summer.[12] And automotive CEOs elsewhere have learned a valuable lesson, too: 41% say they've changed their strategy, risk management or operational planning as a result of this experience.

Natural disasters are far from the only type of disruption automotive CEOs need to plan for. In other research we found that man-made attacks on supply chains are increasing.[13] And in many countries, politics can be a risk factor too. Changes in the political environment can have a major impact on regulations that affect the industry, for example.

11 PwC, 'Autofacts 2011 Automotive review' (2011).

12 PwC, 'Autofacts Regional analysis Asia-Pacific Q4 2011'.

13 PwC, 'Transportation & Logistics 2030: Volume 4—Securing the supply chain' (2011).

> ***"I have identified that as just about my number-one priority in the next few years. How do we attract and develop talent around the world?"***
>
> **Douglas R. Oberhelman**
> Chairman and CEO,
> Caterpillar Inc.

The talent challenge

It's difficult to find the right talent, especially in heavy manufacturing sectors like the automotive industry. And 46% of automotive CEOs say the task is getting even tougher, mainly because there aren't enough skilled candidates. In fact, 56% fear lack of key skills could drag down growth.

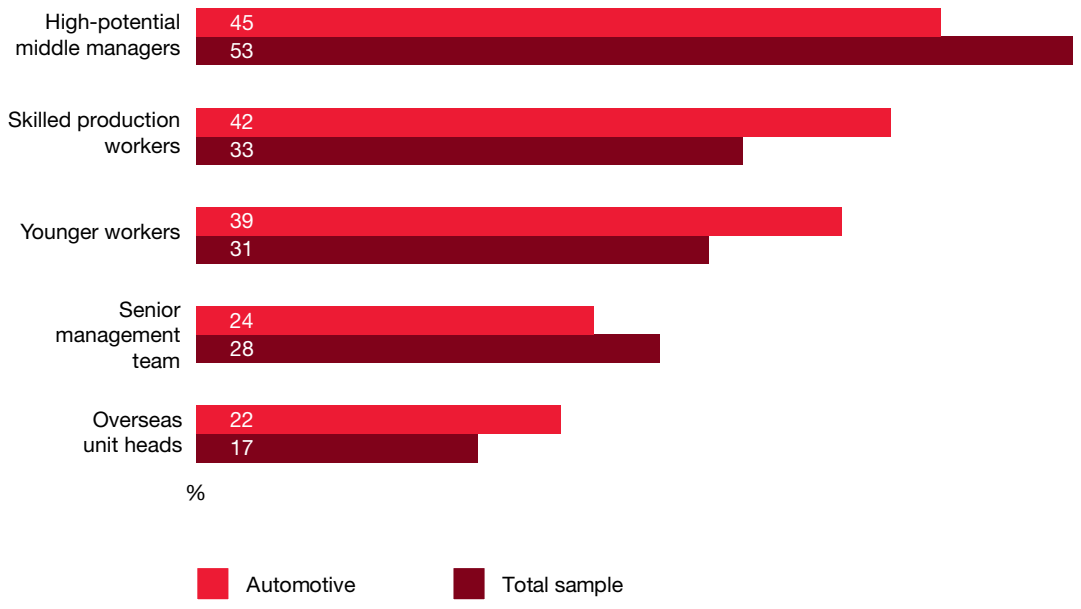
Skills on the line can be hard to find

Engineering graduates are in short supply the world over. They're critical for innovation, but they also represent the biggest pool of candidates for middle management in many companies. In the automotive sector, as in other industries, finding and keeping high-potential middle managers is a major challenge.

What's more surprising is that automotive CEOs say it's nearly as difficult to find and keep skilled production workers (see Figure 2).

Figure 2: Skilled production workers are nearly as big a talent challenge as high potential middle managers for automotive CEOs

Q: With which of the following groups do you currently face the greatest challenges with regard to recruitment and retention?



Base: All respondents (Total sample, 1258; Automotive, 104)
Source: PwC 15th Annual Global CEO Survey

1.3 billion people, and too few automotive engineers

China's explosive growth is triggering severe skills shortages. Fu Yuwu, vice chairman of the Society of Automotive Engineers of China, believes his country can't match auto powers Germany, Japan and the US—and the root cause, he thinks, is the dearth of talent.[14] Fu argues that Chinese automotive companies will have to solve the problem in order to become globally competitive. Some companies are coping by recruiting experienced automotive personnel from Europe, Korea and the US. Others are going outside of China to gather talent, technology and know-how for their operations. That should help close the knowledge gap and make Chinese vehicles more competitive.

That's partly because the industry is growing in regions where the talent pools for the sector aren't yet as well-developed, like China (see sidebar, **1.3 billion people, and too few automotive engineers**), or in technologies that are just emerging. Finding workers who know about electric powertrains, battery recycling, electric vehicle safety and recharging is often difficult, even in regions with long-standing automotive industries.[15]

Automotive companies ahead on tracking people measures

Investment alone won't provide automotive companies with a competitive people strategy, though. It's equally important to get enough information to make the right decisions in the first place. Almost all automotive companies track traditional indicators like productivity and labour costs, although rather fewer measure return on investment in human capital and employee turnover costs—which are also useful benchmarks.

In fact, many automotive companies are already doing a better job tracking some of these measures than those in other industries: 57% of automotive CEOs say they get comprehensive information on labour costs, for example, compared to the overall average of 48%. They're also more likely to get comprehensive information on return on investment in human capital and cost of employee turnover. But there's still a big gap between the amount of information automotive CEOs receive and the amount they'd like to get (see Figure 3). That's important, because talent constraints can impair an organisation's progress: 40% of automotive CEOs say lack of key skills has already affected their company's costs, while 29% report that it's affected innovation and 27% that it's affected their ability to pursue market opportunities.

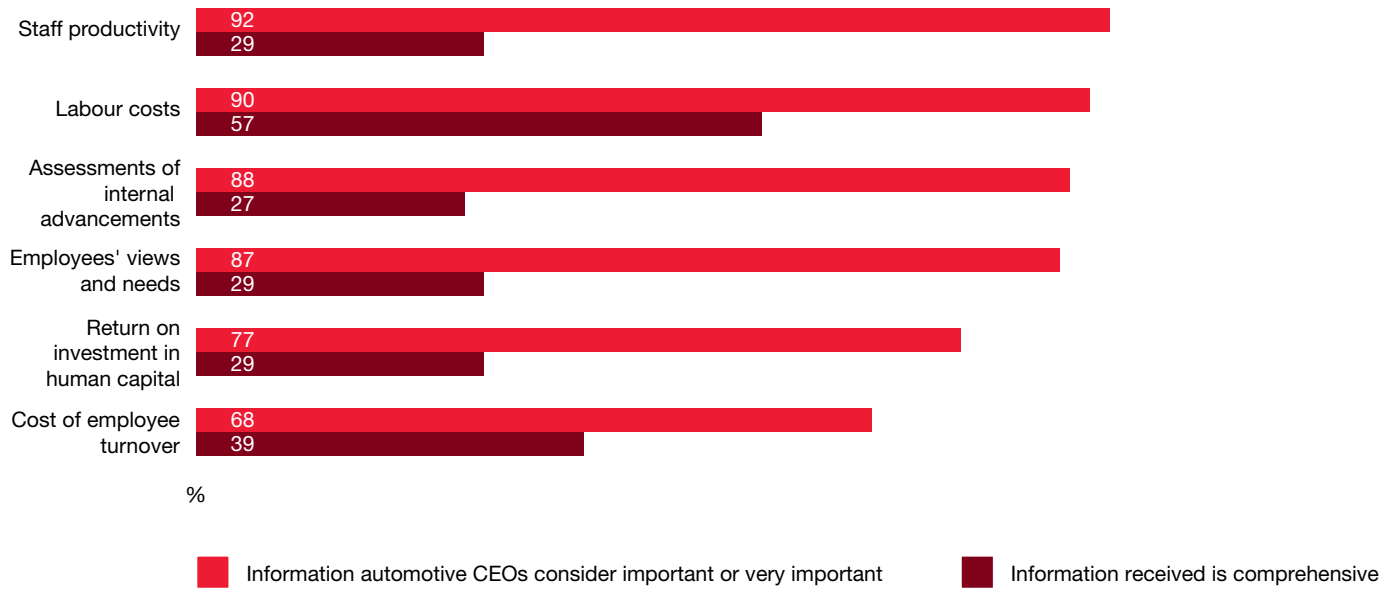
Are major OEMs and Tier 1 suppliers the only parts of the value chain that should be focusing on their investments in human capital? Emphatically not! Another report on the US automotive supply chain took a close look at automotive companies with fewer than 500 employees.[16] The authors note that certain practices—like high wages, worker training and investment and empowerment at all job levels—tend to happen together. Small suppliers using these strategies weathered the economic crisis better than shorter-sighted peers. They experienced nearly 11% less lost revenue.

14 'Talent shortage a bottleneck for China's auto industry', People's Daily Online (18 July 2011), http://english.people.com.cn/90001/90778/90860/7443176.html; 'European auto talent heads for China', China Daily USA (10 June 2011), http://usa.chinadaily.com.cn/business/2011-06/10/content_12671724.htm

15 PwC, 'Autofacts Regional analysis Asia-Pacific Q4 2011'.

Figure 3: Relatively few automotive CEOs have comprehensive information on all the HR measures they view as important

Q: When making decisions, how important is it to have information on each of the following talent-related areas? How adequate is the information you currently receive on each of the areas you view as important?



Base: All respondents (Total sample, 1258; Automotive, 104)
Source: PwC 15th Annual Global CEO Survey

Automotive CEOs committed to workforce development

Automotive CEOs are convinced that the private sector needs to play a major role in creating and fostering a skilled workforce. Just 38% think it should be a top government priority, while 89% believe business in general has a role to play in developing a skilled workforce above and beyond their own employees. They're taking that responsibility seriously. More than three-quarters of them are already making such investments in at least some of the markets where they do business. And even though cash is tight, two-thirds of automotive CEOs are upping their investment in creating and fostering a skilled workforce over the next three years. Formal education programmes already have a strong history in the automotive sector and 42% of automotive CEOs say they're investing in them. An even bigger 66% are investing in adult/vocational education. Both types of programmes are a valuable route towards finding future workers, especially when they're tailored to the needs of the industry.

16 Susan Helper, Kyoung Won Park et al., 'The US Auto Supply Chain at a Crossroads: Implications of an Industry in Transformation' (Case Western Reserve University: Cleveland, 2011).

What's next?

Deciding which processes and capabilities need to be global, regional and local isn't just about taking advantage of growth opportunities; it's also about developing the flexibility to survive disruptions, wherever they may surface. That involves getting the right people into the right roles in the right places. It's not an easy balance to strike. We've distilled eight key questions from the feedback CEOs have given us in this year's CEO Survey:

1. **How local is your global growth strategy?**
2. **How are you balancing global capabilities with local opportunities?**
3. **Is your talent strategy fit for growth?**
4. **Are your innovations creating value for your customers—or just novelty?**
5. **Are you prepared to deal with the consequences of different types of risks (supply chain risk, political risk, exchange rate risk, etc.)?**
6. **Are you responding to the needs and constraints of the communities in which you operate?**
7. **Where are the biggest opportunities for business and government to coordinate better?**
8. **Does your governance model account for the ways in which organisations' and people's expectations are changing?**

If you'd like to discuss any of these questions, please contact us.

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Chairman and CEO
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About PwC's Automotive Practice

PwC's global automotive practice leverages its extensive experience in the industry to help companies solve complex business challenges with efficiency and quality. One of PwC's global automotive practice's key competitive advantages is Autofacts®, a team of automotive industry specialists dedicated to ongoing analysis of sector trends. Autofacts provides our team of more than 4,600 automotive professionals and our clients with data and analysis to assess implications, make recommendations, and support decisions to compete in the global marketplace.

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