

Strategies to steer through
Southeast Asia's promising
automotive market

November 2015

Riding Southeast Asia's automotive highway



In this paper

- 2** Southeast Asia's motoring potential
- 3** An uneven road to growth
- 4** Dual carriageway – Regional manufacturing hub and local sales
- 7** Bumps in the road – Volatility and complexity
- 8** Navigating Growth Markets
- 9** Strategies to steer through complexity
- 15** Cambodia, Laos, Myanmar, Vietnam (CLMV) – The next automotive frontiers

Riding Southeast Asia's automotive highway

Following a few sluggish years, the global automotive scene is starting to look up, most notably marked by an increase in M&A activity in 2014. According to PwC's automotive analyst group, Autofacts, global production is set to rise by 22.3m units between 2014 and 2021, at an annual compounded growth rate (CAGR) of 3.4%.¹ Whilst the BRIC markets have previously led global growth, car sales have dipped 20% to date since December last year, due to slowing growth in China and declining sales in Russia and Brazil, while newer growth markets take the lead. One of these growth regions is Southeast Asia (SEA).²

Southeast Asia's motoring potential

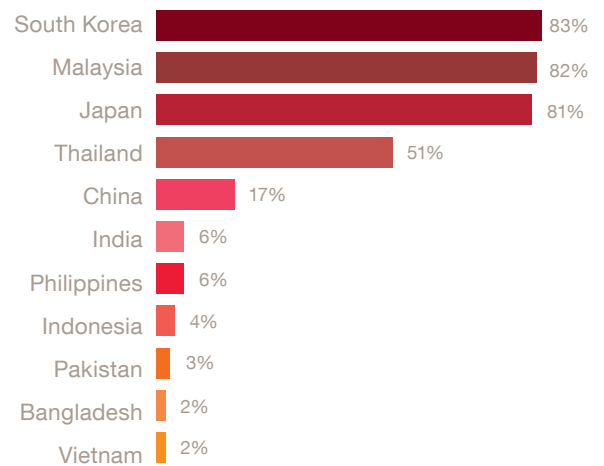
There are many reasons to remain optimistic about the SEA automotive scene. The region has a combined GDP of US\$1.9 trillion, a population of over 600m and an average per capita income nearly equal to China's.

Overall annual GDP growth is forecast at 5.4% from 2014 to 2018, according to the Organisation for Economic Co-operation and Development (OECD), supported by a large, growing middle class, which is expected to more than double to 400m by 2020.

The SEA automotive sector has grown at 11% CAGR in the last 5 years to reach total sales of 3.2m units in 2014 according to the ASEAN Automotive Federation³, and despite the economic slowdown, Southeast Asian consumers continue to have considerably high intent of purchasing new cars – 68% in Thailand and 63% in Indonesia in the next two years.⁴

The region as a whole has low levels of car ownership and many first-time car buyers. It is expected that many two-wheeler owners will eventually convert to four-wheeled vehicles, forming a large group of first-time buyers as affluence grows. Many potential new drivers in the region still own two-wheelers, with motorcycle penetration rates at over 80% in Indonesia, Thailand, Vietnam and Malaysia⁵. In a study conducted by the Pew Research Centre last year, car owners accounted for less than 10% of the populations in Indonesia, the Philippines and Vietnam, compared with 51% in Thailand and 82% in Malaysia.⁵ Enhancing this potential is the fact that many households which do own a car have more than one, and are repurchasing cars within a shortened time frame.

Fig 1. Share of households that own a car (%)



Source: Pew Research Centre, 2014



An uneven road to growth

While SEA has enjoyed a period of strong growth, in recent years performance across the region has been uneven. Car sales have declined in Thailand and Indonesia while stagnating in Malaysia. In contrast, the Philippines and Vietnam have experienced continued growth since the Asian financial crisis.

Overall automotive sales in the ASEAN 7 countries (Indonesia, Malaysia, the Philippines, Thailand, Vietnam, Singapore and Brunei) have fallen by 10%, from 3.5m units in 2013 to 3.2m units in 2014. This decline can be attributed largely to domestic reasons, as well as global economic instability surrounding the Euro zone and rising US interest rates.

The two biggest automotive markets in SEA - Thailand and Indonesia, saw vehicle sales decline last year. In Thailand, new vehicle sales dropped by 33.7% to 881,832 units in 2014³, marking two consecutive years of decline.

Several factors are likely to have contributed to Thailand's weakened performance, starting with the first car buyer incentive scheme launched in 2012. The tax refunds for first-time car buyers that was intended to revive automotive manufacturing significantly increased demand that year, but cost the country US\$2.5bn and have left consumers defaulting on loans. Many who signed on to the scheme changed their minds or could not pay monthly instalments, resulting in their vehicles being confiscated by finance companies and sold at lower prices in the used-car market. This, together with high household debt, an unstable political environment and security threats has diminished consumer confidence and spending.

In Indonesia, car sales have slipped by a relatively smaller margin of 2% from 2013 to 1.2m units in 2014³, but continued to decline in first six months of 2015, slipping 18.2% year-on-year to 525,458 units. Reduced fuel subsidies resulting in raised fuel prices along with a depreciating rupiah have led to the poor sales performance.

On the contrary, smaller markets like the Philippines and Vietnam have shown significant growth.

The automotive sector in the Philippines has benefited from rising per capita income and competitive bank-lending rates. Motorisation rates continue to remain on a steady course towards the next wave of growth, according to Ms Ma Fe Perez-Agudo, president of the Association of Vehicle Importers and Distributors (AVID) and President and CEO of Hyundai Asia Resources, Inc. (HARI) in the Philippines.

Total vehicle sales in the country reached 212,000 units in 2014³, and is forecast to hit 310,000 this year. In fact, car sales reached a record of 19,731 units in March 2015 against last year's 15,292 units in the same month. However, some see this as a rebound from the Asian financial crisis and expect growth rates to level off eventually. Next year's presidential election is expected to have a significant impact on the industry and the country overall, as observers wait to see if the new administration can sustain its current economic growth.

Vietnam has one of the fastest growing automotive sectors in SEA and is experiencing a sales boom. According to the ASEAN Automotive Federation, total vehicle sales have climbed 35% over the past year to 133,588 units³, due to lower interest rates and inflation, coupled with increasing motorisation rates and soaring demand among increasingly affluent consumers.



Dual carriageway – Regional manufacturing hub and local sales

Despite this uneven performance, the region remains attractive for growth, not only from local sales to the 600m people in the region, but also as a manufacturing hub for regional and global exports.

Also, to compete more effectively, automakers are now increasingly localising production of components, instead of just assembling vehicles in the markets. Later in this paper, we will look at strategies for driving sales in these markets and for optimising production capabilities for export within SEA or globally, to drive increased profitability.

Fig 2. Overview of the SEA automotive industry 2014

SEA key indicators

- Population: 619m
- GDP per capita: US\$3,695
- Vehicle Production: 3.88m units
- Vehicle Sales: 3.14m units



Source: BMI, OECD, OICA, Thailand Automotive Institute

All data quoted in Fig 2 shows statistics for the year 2014 only

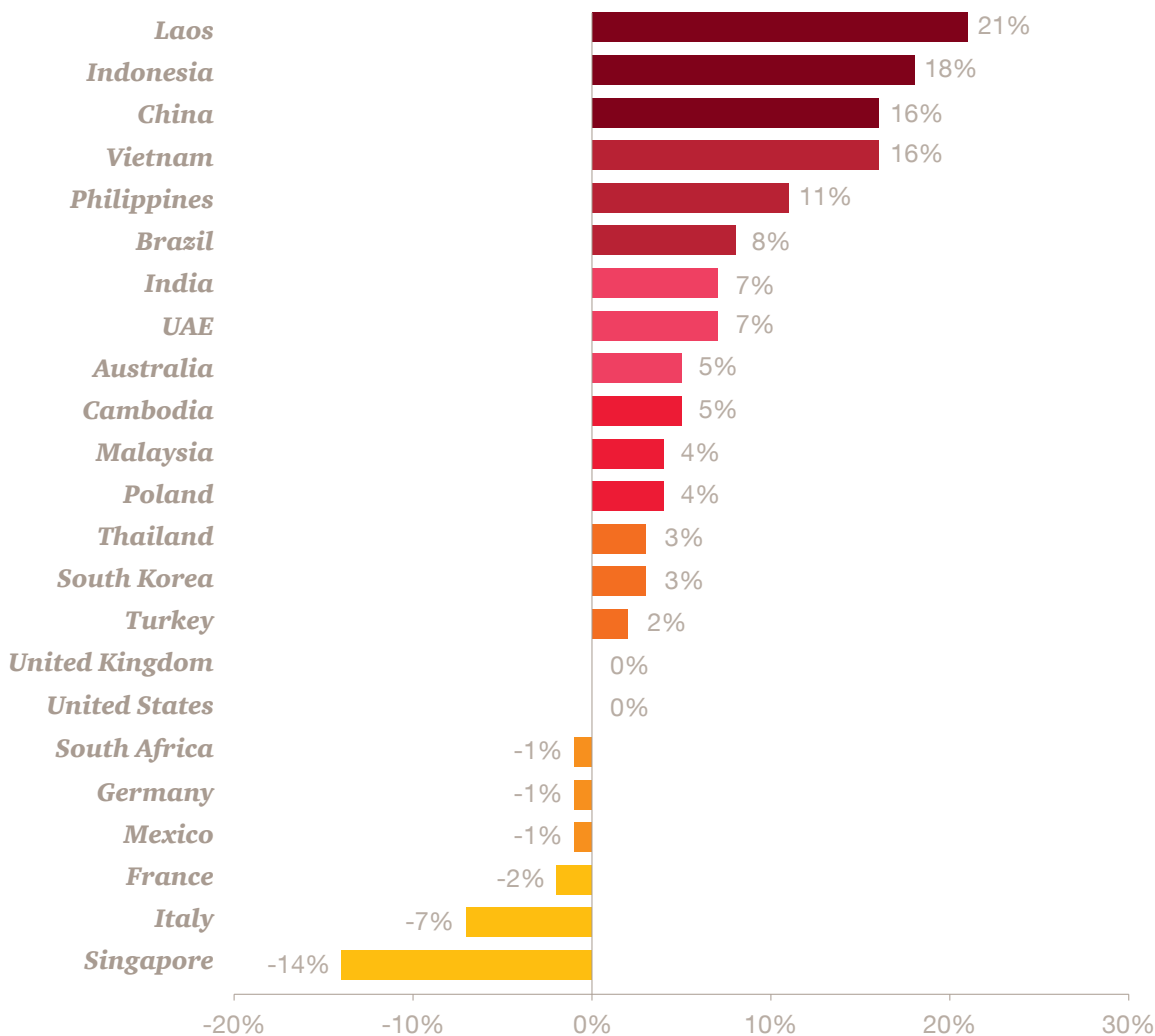
“Vehicle sales” and “Vehicle production” refers to total passenger and commercial vehicle sales and production respectively

SEA's automotive market is dominated by foreign players, led by the Japanese, although European, American and growth market players are increasingly jumping on the bandwagon. Volkswagen (VW) for example, re-entered the Philippines market in 2013 and appointed Ayala Corporation as its distributor. Earlier this year, VW announced plans to invest US\$200m in setting up a manufacturing facility for imported parts assembly and production. Another relatively new entrant in SEA, Tata Motors, is looking to the region to strengthen reviving sales after two years of consecutive decline. It entered the Philippine market last year, is currently aggressively expanding its distribution network for commercial

vehicles in Indonesia, Vietnam and Malaysia, and is now exploring the possibility of a new manufacturing base in Indonesia.

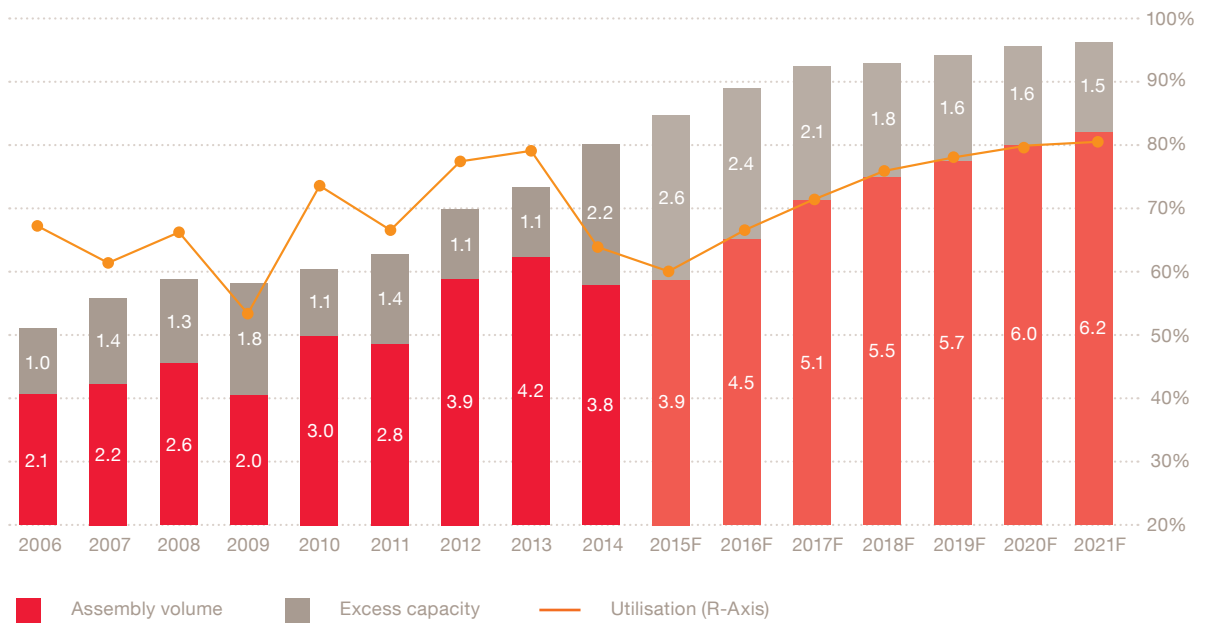
As SEA's leading manufacturing and assembly hub, Thailand has the most comprehensive auto parts supplier base, attracting more and more automakers to set up R&D plants there. From being a large consumer market, the country has evolved into an export hub serving both the immediate region and beyond, including the Middle East, China, India, Europe and America.

Fig 3. Vehicle Sales Growth by Country, 2006 - 2014 (CAGR %)



Source: BMI
 "Vehicle sales" refers to total passenger and commercial vehicle sales

Fig 4. Light Vehicle Assembly Outlook in ASEAN (2006 - 2021), in millions



Source: Autofacts 2015 Q4 Forecast Release

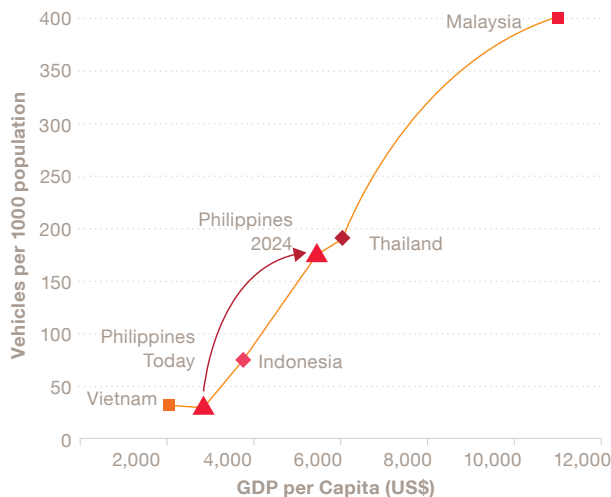
Last year, about 60% of the 1.13m vehicles produced in Thailand were exported, the majority of which were mid-sized pick-ups and small cars, with the rest sold domestically. Overall exports from Thailand have risen by 2.9% in the first half of this year to 576,073 units, making up for domestic sales which declined by 16.3% to 369,004 units over the same period. According to PwC's Autofacts, assembly for light vehicles in ASEAN will continue to grow and is projected to reach 3.9m units in 2015¹.

Indonesia continues to challenge Thailand's position as a production and export hub following

significant expansion plans by multiple major car manufacturers, as Thailand's volatile political environment have threatened its attractiveness for foreign investment. Supporting this shift is Indonesia's domestic automotive demand, which totalled 1.21m units, overtaking Thailand's domestic market of 881,832 units in 2014.

These two markets are also leading the drive to be eco-car production and export hubs. Their governments have each launched eco-car schemes, namely the Eco-Car Program in Thailand and the Low Cost Green Cars (LCGC) scheme in Indonesia. These schemes offer incentives on production of eco-cars that meet emission and local content requirements. These eco-cars are seen to be the cars of the future; low-cost, fuel efficient and environmentally friendly.

Fig 5. Market maturity in terms of vehicle penetration 2014



Source: BMI, EIU, PWC analysis

"Vehicle penetration" includes total passenger and commercial vehicle penetration

Auto sector growth in the Philippines is tied closely to its rising domestic demand as is the case in Indonesia, and is currently at an inflection point (refer to Figure 5). Foreign investment continues to drive the economy, along with a growing business process outsourcing (BPO) sector. An increasing base of first-time buyers, many of whom are BPO employees, together with rising affluence and favourable lending rates propel domestic growth of the automotive sector.

Fig 6. Key Automotive Industrial Zones in Southeast Asia



The Philippine government has approved tax incentives for automakers to boost production of new car models and is also constructing more roads in provincial areas outside Metro Manila. The recently approved Comprehensive Automotive Resurgence Strategy (CARS) is expected to bring in new parts manufacturing investments, produce at least 600,000 vehicles and generate some 200,000 new jobs with a total economic value of US\$ 6.5bn or 1.7% contribution to GDP.⁶

Bumps in the road – Volatility and complexity

While regional initiatives like the ASEAN Economic Community (AEC) and AFTA (ASEAN Free Trade Agreement) are aimed at creating an integrated ASEAN market and production base to enhance trade flow, these remain ongoing efforts as individual countries are committed to these initiatives at varying levels. Customs regulations still differ from country to country, and individual countries are able to impose taxes to compensate for the removal of non-tariff barriers. Several of the automakers that we spoke to also expect that goals set out by the AEC will take time to materialise.

Infrastructure remains a major obstacle to economic progress in the region, as it is to motorisation rates. The growth in vehicle ownership outpaces growth in road development and traffic jams hinder the transition from two-wheelers to four-wheelers. Jakarta's sole port is overly crowded, leading to delays in shipments, in and out of the country. On top of that, road



congestions and under-developed road networks result in logistical inefficiencies and create obstacles to productivity. In an attempt to address some of these issues, the Indonesian government has pledged to increase spending to invest a record US\$22bn on infrastructure projects this year, 53% more than was allocated last year.

Incentives given by local governments to boost the automotive industry do not often achieve their intended effect. Just as the first car buyer policy in Thailand had the unintended consequence of depressing car sales in subsequent years post its implementation, automakers in the Philippines remain in a “wait-and-see mode” as they await the Implementing Rules and Regulations (IRR) of the recent Comprehensive Automotive Resurgence Strategy (CARS) scheme. Through the CARS scheme, the government has promised to offer fiscal incentives to automakers that achieve production of 200,000 units over a period of six years and meet local content requirements. The scheme is seen to tip the balance towards bigger players such as Toyota and Mitsubishi Motors, given that other manufacturers will struggle to meet production requirements and justify the higher costs involved in generating such volume, potentially outweighing incentives offered.

In addition, operational costs are rising across SEA. Labour wages are increasing, although still lower than in the more mature BRIC markets. In Indonesia, the minimum monthly wage has jumped 60% to US\$205 (2.8m rupiah) over the last two years, partly due to intense lobbying by labour activists.

High energy costs, opaque regulations and inadequate market governance in the Philippines combined make it a challenging location for automakers to operate in. In 2012, Ford closed its manufacturing facility in the Philippines as part of the restructuring of its regional manufacturing operations to improve efficiencies and costs, and better leverage economies of scale. Instead, it switched to importing its vehicles for domestic sale. According to industry estimates, it costs US\$1,800 to US\$2,000 more to produce a locally assembled car in the Philippines than it does to import a complete vehicle.

Navigating Growth Markets

Growth markets like SEA come fully equipped with their own set of challenges, and hence the onus is on companies to demonstrate adaptability and develop an astute understanding of the markets. Success may appear elusive in tougher times but is still possible.

Honda bucked declining car sales in Thailand to report a sharp rise of 42.6% year-on-year with 18,892 units sold in the first two months of 2015.⁷ This is despite the market’s overall 11.8% decline, with top brands like Toyota reporting a year-on-year sales decline of -20.5% in the same period.⁷

Meanwhile, German automaker Mercedes Benz sold 1,795 cars in Indonesia during the first seven months of 2015, a 20% increase from the 1,500 cars sold in the same period in 2014.⁸ This is in contrast to a 21% decline in total car sales in Indonesia to 581,106 units during the same period this year, according to the Indonesian Automotive Manufacturers’ Association (GAIKINDO). Mercedes Benz currently controls 49% of the premium car market, an increase of 11% market share from a year ago.⁸

Similar cases are seen in slightly more mature growth markets such as China, where growth is slowing. General Motors (GM) continues to report earnings with sales from new SUVs and Cadillacs, both premium products. It is also having some success in Tier 3 and below markets as consumers’ buying power improves.

So how have certain companies managed to navigate these complex environments and institutional voids, where others have struggled? Based on in-depth interviews with global automotive players in the region, automotive associations and PwC automotive experts, we have outlined key strategies pertinent to succeeding in the SEA auto sector. This covers two key themes: driving sales whilst marketing to consumers, and enhancing production profitability.



Strategies to steer through complexity

Strategy 1 – Differentiate with customisation and innovation

The auto sector in SEA is growing, but in the early days of production, whilst sales volumes were small, it was hard for automakers to justify manufacturing locally. Hence, it was also not profitable to develop customised vehicles for the Southeast Asian consumer.

However, with rising sales across the region as a whole, automakers are starting to tailor vehicles to the needs of SEA consumers. With a burgeoning middle-class, a growing market of first-time buyers and competitive prices due to trade liberalisation, Asia-specific models may become more economically viable.

Honda has aggressively invested in customised cars for growth markets Indonesia, India and China since 2014 and this is starting to pay off as it claims market share from top rivals VW and Toyota Motors. In fact, Honda had enlisted local design engineers to develop interior and exterior features that reflect local tastes. Meanwhile, it continues to reserve engine, body and core components in Japan.

So what do consumers in Southeast Asia prefer in their vehicle? This is perhaps exemplified by Honda HR-V's outstanding sales in the region. While vehicle sales of the major players in Thailand have declined, the Honda HR-V, a compact SUV model, bucked the downward trend. With demand exceeding supply, Honda is still coping with back orders.

The Honda model has sold well across SEA generally, as it has the right combination of features. Its sporty design appeals to a wide variety of customers, including younger people, and the fact that it is smaller and thus cheaper than many of its competitors makes it more appealing in times when consumer confidence is not high.

In SEA, pricing is a key aspect of customisation. While SEA's consumers started out with a love affair for large vehicles – family sedans and pick-up trucks – the compact SUV is the newly favoured and more affordable hybrid. They are defying sluggish sales trends in the region and are selling fast. Meanwhile, leading players like Toyota have offered SUVs which are larger than Honda's, but these are also more expensive, and consumers have not taken as well to them.

Consumer preference in Thailand is shifting to smaller cars, not only because of lower prices but also lower operating costs as compared to sedans or pickup trucks. Until now, sedans have been popular in Thailand, while Indonesians are more accustomed to multi-purpose vehicles as they can carry more people. Daihatsu Motors is updating its three-row seater, Xenia, which is very popular in Indonesia. The new version will improve fuel economy by 10-20%.

Understandably, automakers' hands are tied by certain car specification requirements such as emission standards, which are not standardised across the region. As SEA markets align and move towards one single consumer base, localising for the entire region may make more financial sense, if not for individual markets.

Strategy 2 – Affordable luxury is the “in” thing

Car ownership is a way of fulfilling aspirational needs for the typical Southeast Asian consumer. The desire of non-car owners to own cars in Indonesia is the third strongest in the world⁹, with an aspiration index of 96%. At least 67% of car owners consider their cars a symbol of success, and feel that it boosts their social status.⁹

In line with this aspirational need, cars positioned solely as low-cost are unlikely to attract many consumers. SEA auto players can learn from the Toyota Etios in India, which was perceived to have poorer than expected quality and aesthetics, and was poorly received despite being one of the lower-priced vehicles in the market.

It appears that combining status symbol desires with affordability is an important balance to strike, even as it appears conflicting. While consumers expect the new cars to be attainable price-wise, they also want them to be seen as premium or “affordable luxury”.

Japanese and European automakers are targeting wealthy Thai customers to launch new SUVs at a time when sales of new cars in the country are weak.

Mitsubishi Motors released the new SUV Pajero Sport with a starting price of over US\$32,000 and plans to sell 7,000 units in the next year¹⁰. French car manufacturer, Renault, has also recently launched its compact SUV in India and plans to export this to several countries in SEA.

The affluent population in the region shows promise as a segment on its own. It is set to more than double from 18.3% across Indonesia, Thailand, Myanmar and Vietnam in 2012 to 45.7% in 2020.¹¹ There will be 43m people entering the US\$10,000 to US\$25,000 income bracket in Indonesia and 13m people in the Philippines.¹²

The affluent segment has also proven to be a resilient and growing segment. The world’s top 75 luxury goods companies generated US\$171.8bn in global sales in 2013 despite the then persistent economic turbulence, mounting troubles in the Eurozone and ongoing political instability in several growth markets. Globally, the luxury automotive sector dominates overall luxury sales, with \$439bn in revenue and 6% growth.¹³

Luxury cars continue to resist depressed car sales in Thailand and instead, automakers remain optimistic, expecting luxury car sales to increase

Fig 7. Change in number of people in households by income group (mn), 2015-2019

Income Group (US\$)	China	India	Indonesia	Philippines	Vietnam
Sub-1k	3	-21	-2	-1	-6
1-5k	-56	-259	-30	-13	-4
5-10k	-95	341	3	10	18
10-25k	-10	-5	43	13	0
25-50k	203	-8	-1	0	-1
50k+	10	23	4	1	2

Source: BMI forecasts



by 10-12% this year, exceeding 20,000 units. In the first four months of this year, luxury car sales grew to 7,000 vehicles, as opposed to overall domestic car sales, which declined by 15.3% to 251,845 vehicles.¹⁴

Many automakers are seizing opportunities in the SEA luxury segment. Rolls-Royce Motors opened its first Asian boutique in Central Bangkok and has plans to further expand its presence in Thailand. Less than two years ago, BMW opened Rolls-Royce showrooms in Manila and Hanoi. The Head of Asia-Pacific operations for BMW's ultra-luxury car segment Paul Harris, was quoted by Bloomberg saying, "We've come in right at the beginning of a growth we see continuing. Given the combination of stability, the growth rate and the overall business atmosphere, it would be wrong for us to come to the Philippines at any other time. In fact dealers are already receiving enquiries."¹⁵

Strategy 3 – Invest in managing a dealer network

Driving sales by expanding dealership networks has been a key focus for some of the international automotive players that are looking to tap into the fast-growing SEA market. Nissan in Indonesia has been expanding their sales network and setting up dealerships despite the overall slowing economy. The automaker plans to do the same in the Philippines following its joint venture with Universal Motors to form Nissan Philippines Inc. Especially in the Philippines, where the automotive sector has remained upbeat, automakers are aggressively expanding into the provincial areas to reach out to more customers.

Automakers in the Philippines work hand in hand with local dealers, especially when venturing into less familiar provincial areas, making it essential to cultivate sound relationships with their customer-facing business partners. This is in contrast to the situation in Japan, where automakers have exclusive dealer representatives. In SEA, dealers mostly carry multiple brands; hence the manufacturer-dealer relationship is not exclusive.

Nevertheless, bigger Japanese players still have the upper hand, as their brands sell well and bring in a substantial volume of customers. Also, some of the Japanese players have been in the market for a long time and have developed strong, long-standing relationships with their local dealers.

For newer market entrants, however, the picture is not as rosy. Dealer management challenges range from lack of buy-in and commitment to targets from dealers, being unable to hit sales quotas, high sales staff turnover, unavailability of models leading to the loss of sales opportunities, and/or management not effectively monitoring and obtaining information from dealers.

A point of contention between manufacturers and dealers often revolves around setting sales targets. Given the slim margins that dealers make on new car sales, their focus naturally turns to after-sales servicing and auto part sales. In order to drive sales, some automakers are offering incentives to motivate sales staff directly, in the form of cash or travel. Automakers also utilise incentive schemes to cope with high staff turnover, but arguably more needs to be done by the manufacturers to support dealers in building employee loyalty as a long-term solution.

Japanese automakers have excelled in ensuring that quality standards are met and adhered to by imposing stringent accreditation procedures, while balancing this delicately with establishing dealer relationships based on trust. They often impose strict standard operating procedures, training requirements and scrutiny on their dealers. In some cases, sales agents are tested on standard service procedures and those who do not pass these tests will not be allowed to sell or deal with customers directly. However, some automakers have also been known to give dealers a free hand in designing the customer experience. This can range from doing up showroom interiors to training and delivering on the sales experience.

There was an instance where a dealer had terminated their working relationship with a new growth market entrant despite good sales potential. The relationship failed after the automaker exercised stringent terms on dealers and was highly inflexible with its demands despite negotiations.

Strategy 4 – Stay ahead of the digital game

About one in four (22%) of SEA's population live in cities of more than 200,000 inhabitants and an additional 54m people are expected to move to cities by 2025. As urbanisation increases, so does internet and mobile penetration in growth markets. ASEAN consumers are increasingly moving online, with mobile penetration of 110% and internet penetration of 25% in 2015. Indonesia, with the world's fourth-largest population, is rapidly becoming a digital nation and it is expected to have 100m internet users by 2016.

With this digital phenomenon, it is becoming increasingly important for businesses to establish an online presence and to connect with customers via social media. After all, SEA countries make up the world's second-largest community of Facebook users, behind the United States. Social media users in the Philippines (3.4 hrs), Malaysia (2.8 hrs), Thailand (2.6 hrs) and Indonesia (2.4 hrs) are found to spend the highest number of hours in a day on social media globally.

From an automotive standpoint, one in four car buyers use social media to discuss or communicate a recent purchase experience¹⁶, and about one in three (38%) of consumers report that they will consult social media or research online the next time they purchase a car.¹⁶ In a survey of Indonesian consumers, 97% claimed they will or intend to post their vehicle experience on social media¹⁷ while 98% of car buyers said they use social media for vehicle research.¹⁷

Automakers are increasingly reaching out to consumers via digital marketing. BMW's Facebook fan page has attracted more than 18.5m likes. MINI launched a "Not Normal" campaign and asked people to upload images and videos to Tumblr or share with the hashtag #mininotnormal, resulting in 30,000 new followers and fans and 3,853 people visiting the campaign hub to look for a new MINI. Global tyre brand Goodyear set up an online webshop this year after discovering that many of its consumers were researching tyres on their website before purchasing in-store.

Automotive e-commerce has grown at a staggering rate in developed markets - as many as 80% of new car customers and almost 100% of used car customers begin their car shopping experience online.¹⁸ We expect that it is only a matter of time before growth markets will catch on to these trends as well, given rising internet and mobile penetration rates. In the Philippines for example, car dealers have become more digital when it comes to advertising their listings. Over 60% of dealers use the internet, about half advertise on online classifieds and about a third have turned to social media.¹⁸

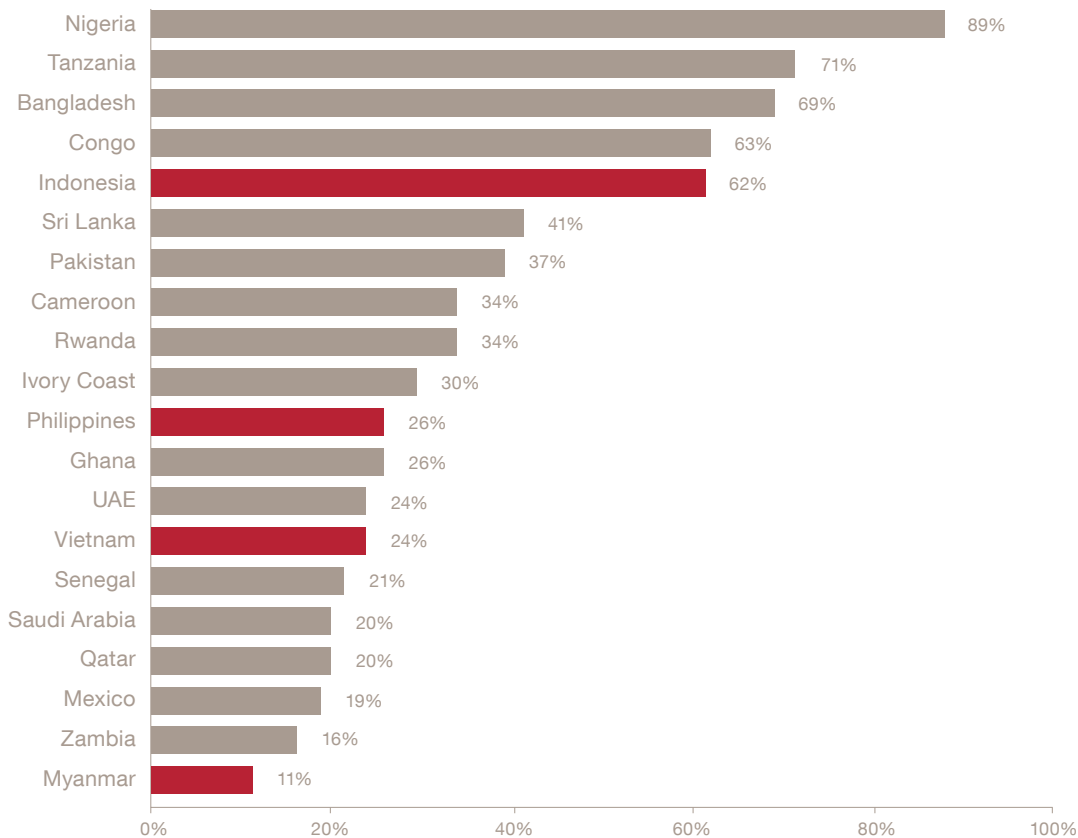
In fact, growth market consumers are more likely to purchase a vehicle online, with 49% of consumers from BRIC markets exhibiting greater tendency to do so compared to 37% in mature markets. In Indonesia almost half of those looking to purchase a vehicle will do so online.¹⁷ It is likely that consumers in developed markets are far more acquainted with visiting physical stores when purchasing cars and hence less inclined to change than growth market consumers.

However, not only is digital engagement pertinent to generating new sales, it is also equally vital to customer retention and building loyalty over the longer term. Digital marketing also exposes automakers to vehicle retail aside from the wholesale and distribution business. It offers a platform for the automakers to connect directly with end customers rather than via dealers. In this way, automakers can observe different aspects of the customer journey, for example, through monitoring online conversations, from researching brands and models through to the actual purchase activity and after-sales feedback.

On the flipside, the digital platform exposes the customer to information sources other than the dealers. Consumers are increasingly using multiple platforms, including Original Equipment Manufacturer (OEM) and dealer sites, forums, blogs and social media to gather information and compare prices and offers before making their final purchase decision.

Fig 8. Carmudi Report – Growing number of automotive search queries online

Google search queries on automotive, year-on-year search growth by country, 2015.



Source: Carmudi

Strategy 5 – Invest in employee development and talent retention

The lack of available talent is a common challenge in many growth markets. In Thailand and Indonesia, this challenge is less acute but still present. Those with existing skills still need them scaled up and improved, especially for more senior managerial positions. Staff retention is an issue especially in the Philippines, as its workers are educated to a higher level than many other SEA countries and are proficient in English. Thus, they are more in demand and more likely to seek overseas work opportunities which will pay them better salaries.

Many multinationals rely on bringing in talent from their headquarters as a solution to the shortage of local skills, but it is a short-term measure. This approach has further problems in certain SEA countries where governments are more likely to exercise protectionist agendas to safeguard local employment. The Indonesian government, for example, has made it more difficult for foreign work visas to be renewed, as the country exhibits protectionist tendencies in fear of foreign talent being preferred over locals.

Helping local workers scale up their skill levels is a far more sustainable long-term solution. One automaker in particular, sends its senior employees

for three-month training stints in Japan who then return to train other employees. This not only increases the skills of the employees, but also increases motivation and morale, as local workers see themselves as part of the global business and not just cheap local labour.

In another progressive move, one of the largest automotive distributors and dealers in the Philippines has invested in a vocational training school where students receive training for free with a view to working for the company after graduation. In turn, these students repay the company for their education over a period of time with a minimal sum deducted from their monthly wages. Thailand is also exemplary in investing in skilled workers as it has set up a common automotive educational institution which has been producing quality technicians hired by top automotive players.

International companies can refer to the above tactics, bearing in mind that growth markets' employees often aspire to better themselves and also have numerous financial responsibilities which increases their financial burden. Initiatives which recognise these needs and provide for dependants too will help retain employees' rare and valuable talent without continually having to raise salaries or enter wage wars with competitors.

Strategy 6 – Leverage local expertise

Leveraging the expertise of existing players in growth markets can be extremely helpful in mitigating the challenges and risks of entering and expanding in a new growth market, and it does not always have to be with a domestic player.

In 1996, Ford was the first automaker to heed the Thai government's call for investment to help develop a globally competitive auto industry by making a US\$500m investment - nearly five times the largest investment of its kind at that time - to set up a joint-venture production and export facility with Mazda, of which Ford already had a controlling stake in. The Ford and Mazda alliance was a successful exchange of valuable expertise: Ford in international marketing and finance knowledge and Mazda in manufacturing and product development. Both companies collaborated in producing and designing car models, with Ford doing most of the styling and Mazda making key engineering contributions. The JV facility, AutoAlliance Thailand Co. Ltd., which has been continually expanded since the initial investment, exports half of its produced vehicles to markets across Asia, Africa and Europe.

Foreign automakers can explore partnerships with multinationals that have already established a firm footing in the growth market, as in the case of Ford and Mazda, or a local incumbent which has good connections and market access. In the Philippines, Korean automaker Hyundai was able to increase its sales in a short period of time and gained good volume shortly after entering the market by partnering with local dealers and using their network to gain volume.

However, not all partnerships in the automotive sector are profitable. A key to success is to gain a good understanding of the expectations of the potential partner. Growth market companies may have higher expectations of partnerships than before. Previously, it used to be sufficient for the foreign company to offer access to technology and sophisticated management solutions while the role of domestic partners was to make key government connections and cater for low cost production. Now, the local firm may want to invest capital, contribute to the development of technology capabilities, or engage in a global partnership which will provide international exposure.

For example, Indian vehicle manufacturer Bajaj Auto had requested Japan's Kawasaki to be its partner for expansion into other markets, as part of their alliance.

Another key aspect of leveraging expertise in growth markets is in localising supply chains. Working with local suppliers offers benefits of strengthening the supply chain with improved efficiency and cost reduction. In recent years as the auto parts industry in SEA has matured, automakers have been successively localising, in part due to rising volumes and government offering incentives for vehicles with greater local content.

While Toyota's vehicles have high local content rates sourced in SEA, Mitsubishi Motors in Indonesia has set up a joint manufacturing company with local partner PT Krama Yudha which will result in higher local content utilisation. Looking for lessons from China, General Motors (GM) has been able to reduce costs for materials used in Chinese models and build higher priced SUVs with its Chinese partners, in order to help sustain margins in a declining Chinese market.

Moreover, Southeast Asian governments have preferred populist policies that protect the interest of their local companies. In these cases, foreign companies have to work with local companies in order to operate in the market. Also, heavy taxes of up to 40% are imposed on completely built-up cars (CBU) in Indonesia, and lower taxes for completely knock-down cars (CKD), except those imported from other ASEAN countries, thus forcing manufacturers to assemble or source locally to suppress costs.



Cambodia, Laos, Myanmar, Vietnam (CLMV) - The next automotive frontiers

Despite the uneven performance of the auto sector in SEA, especially with declining sales in the two biggest auto markets, Thailand and Indonesia, industry insiders we have spoken to remain optimistic.

To offset the slowing sales and saturation of Thailand's domestic auto market, it is positioning itself as the region's manufacturing and export hub. Indonesia, on the other hand, is effectively competing with Thailand to be an auto hub, with domestic sales already exceeding those of Thailand, and its government is stepping up infrastructure investment and governance to attract foreign investment. The Philippines has a steadily growing auto sector, and represents a large domestic market of its own.

While Thailand, Indonesia and the Philippines have more mature automotive sectors and continue to attract foreign investment, new frontier markets have also caught the foreign investor's eye. Cambodia, Laos, Myanmar and Vietnam (CLMV) countries represent a growth region of about 156m people.

With an annual economic growth rate in CLMV of at least 7% compared with Thailand's 0.7%, the middle class consumers in the region will be a key driver of economic growth. However, with a combined GDP per capita still below US\$1,700, as compared to Thailand's US\$6,022 per capita and Indonesia's US\$3,513 per capita, it will take time for automotive demand to become established. Nevertheless, strong urbanisation rates are driving demand for consumer goods, with Laos alone recording an urbanisation rate of 5% annually.

Given the low but improving GDP per capita across CLMV, the growth opportunity remains to be tapped into. Many in CLMV have never owned a car: car ownership average 32 cars per 1,000 people across the region, compared to 75 cars per 1,000 people in Indonesia and 184 in Thailand. Currently, vehicle sales are also low in Vietnam (130,000 units in 2014) and Cambodia (30,000 units), as compared to over 880,000 units in Thailand and 1.21m units in Indonesia, indicating ample potential for the auto sector.

Despite the need and desire for more vehicles across CLMV, the region's infrastructure is still in need of significant development. Myanmar has a road network to land mass ratio of 1:19, compared to Thailand, which has a ratio of 1:5. As a result, 50% of all freight in the country is transported

by river barges which are heavily dependent on seasonal changes in water levels.²⁰ Apart from the shortage of road networks, the quality of existing roads is also poor. For example, Cambodia ranked 93 out of 144 for road quality globally, Myanmar ranked 134 and Vietnam ranked 102 according to the World Economic Forum's Global Competitiveness report.

In Myanmar, there is already demand for heavy trucks used in infrastructure and dam building projects and this is likely to increase as improved roads create better conditions for long-haul transportation of goods. A significant number of infrastructure projects are also in the pipeline. Currently Cambodia lacks a port, which inhibits ease of trading, but the country is set to benefit from increased outbound infrastructure investment from China with the establishment of the Silk Road Fund. According to the Chinese Ambassador to Cambodia, Bu Jianguo, China has provided financial aid to Cambodia to build 2,669km of roads, representing 35% of Cambodia's total roads. The Commercial Bank for Investment and Development of Vietnam (BIDV) will also lend US\$147m to Laos for two infrastructure development projects, including the planned railway connecting Kunming to Thailand running through Laos.

As we can see, realising the potential of the Southeast Asian automotive market is complex and requires a nimble growth strategy that can accommodate different growth trajectories and needs of each country. Transitioning from a strategy that only addresses local demand to one that also serves regional and global consumption needs is a tricky but necessary journey. However, if made successfully, this approach can transform SEA into the next global hub for automotive manufacturing, serving Asia and beyond.

Authors

David Wijeratne
Growth Markets Centre Leader

Stella Lau
Automotive, Growth Markets Centre

Acknowledgements

PwC Thailand

Varaporn Vorathitikul
Partner, Assurance

Atsushi Uozumi
Partner, Tax & Legal Consulting

Paul Sumner
Partner, Worldtrade Management
Services, Mekong & Philippines

PwC Indonesia

Satoshi Arai
Technical Advisor, Consulting

Shunsuke Wariishi
Advisor, Consulting

Hendra Lie
Partner, Tax Services

PwC Philippines

Alexander B. Cabrera
Chairman and Senior Partner

Aldie P. Garcia
Partner, Assurance

Benjamin Azada
Partner, Consulting

Raoul A. Villegas
Director, Deals & Corporate Finance

Rocky Saldajeno
Senior Manager, Markets

Yumi Ishii
Manager, Consulting

Maila Jean V. Roque
Manager, Markets

PwC Singapore

Kenji Katsura
Partner, Consulting, Southeast Asia

Richard Skinner
Partner, Deals Strategy Group,
Southeast Asia

Nisrita Sanagaram
Manager, Deals Strategy Group,
Southeast Asia

PwC Japan

Takayuki Kusajima
Director, Consulting

Autofacts

Tsukasa Watanabe
Senior Manager

Automotive Companies & Associations

Michael Smuts
Chief Financial Officer, ASEAN
Ford Services (Thailand) Co., Ltd.

Fumiya Yamakita
Controller, Accounting & Finance
Department
Isuzu Motors Co., (Thailand) Ltd.

Soichiro Narahashi
Coordinator, Accounting & Finance
Department
Isuzu Motors Co., (Thailand) Ltd.

Taku Yamafuji
Director, Corporate Planning
PT. Mazda Motor Indonesia

Kazufumi Tamaki
General Manager, Corporate Planning,
Marketing & Sales Strategy
PT. Nissan Motor Distributor Indonesia

Toshio Kuwahara

President & General Manager
Honda Cars Philippines, Inc.

Yusuke Nishi
First Vice President, Corporate
Planning Group
Mitsubishi Motors Philippines

Dante S. Calma
Assistant Vice President, Market and
Product Planning Department
Mitsubishi Motors Philippines

Willy Q. Tee Ten
President
Autohub Group

Anthony Cheng
President
Matterhorn Motor, Inc.

Mike A. Tan
Business Partner
Matterhorn Motor, Inc.

Ma Fe Perez-Agudo
President, Association of Vehicle
Importers and Distributors (AVID)
President and CEO, Hyundai Asia
Resources, Inc. (HARI), The Philippines

Thanawat Koomsin
President
The Thai Automotive Industry
Association

Noegardjito
Secretary General
The Association of Indonesia
Automotive Industries

Budi Prasetyo Susilo
Senior Advisor
The Association of Indonesia
Automotive Industries

Notes and sources

1. PwC's Autofacts, Global Analyst Briefing, Q4, 2015
2. References to Southeast Asia (SEA) in this article includes eleven countries (Singapore, Thailand, Indonesia, Philippines, Vietnam, Malaysia, Myanmar, Laos, Cambodia, Brunei, East Timor)
3. ASEAN Automotive Federation, Statistics, 2007 to 2014 (<http://www.asean-autofed.com/statistics.html>)
4. Nielsen Global Automotive Demand Report, 2014
5. Pew Research Centre, Spring Pew Global Attitudes Survey, 2014
6. Department of Trade & Industry, the Philippines
7. New Vehicle Sales by major makers, Toyota Motor Thailand Co. Ltd. (TMT)
8. "Mercedes Benz sales up 20% as Indonesia Economy Sags", The Jakarta Globe, August 16, 2015
9. Nielsen Online Global Survey, 2013
10. "Automakers target top end consumers", Nikkei Asian Review.com, August 5, 2015
11. Boston Consulting Group, "Vietnam and Myanmar: Southeast Asia's New Growth Frontiers", 2013
12. Business Monitor International (BMI), "Economic Analysis – The Asian Consumer: A Decade of Demand Ahead", 2015
13. Bain & Company, Luxury Goods Worldwide Market Study Fall-Winter, 2014
14. "Luxury cars continue to buck market", The Bangkok Post, June 12, 2015
15. Bloomberg Business, "Rolls-Royce Targets Manila Rich as Hanoi Beckons: Southeast Asia", 21 June 2013
16. The Chief Marketing Officer (CMO) Council report, "Facts & Stats", 2014 (http://www.cmocouncil.org/facts_stats.php)
17. Capgemini, "Cars Online; Generation Connected", 2014
18. Carmudi, "The Booming Automotive Industry in Emerging Markets", 2015
19. Organisation Internationale des Constructeurs d' Automobiles (OICA), otherwise known as The International Organization of Motor Vehicle Manufacturers
20. Business Monitor International (BMI) reports

At PwC, our purpose is to build trust in society and solve important problems. We're a network of firms in 157 countries with more than 208,000 people who are committed to delivering quality in assurance, advisory and tax services. Find out more and tell us what matters to you by visiting us at www.pwc.com.

This content is for general information purposes only, and should not be used as a substitute for consultation with professional advisors.

© 2016 PwC. All rights reserved. PwC refers to the PwC network and/or one or more of its member firms, each of which is a separate legal entity. Please see www.pwc.com/structure for further details.