



# ***With the automotive industry on the motorway of growth***

*Automotive trends on  
the Slovak-Hungarian axle*

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## About the study

The European automotive industry is currently under restructuring that results in the increasing share of the East-Central European region. The results of the most recent Slovak, Hungarian and Global CEO Survey made by PwC provide an excellent opportunity to describe the comprehensive automotive trends of the two countries of the East-Central European region – Hungary and Slovakia – that play an important role in the automotive industry<sup>1</sup>. Based on the data we can also see how the expectations and business policy of the automotive industry players deviate, in relation to both countries, not only from the other economic players of both countries but also from each other, providing a picture of the company shaping strength of the economic policy and business environment. Thirdly, taking also the results of the global CEO Survey into consideration, we can also get answers to the question which direction the CEOs operating in an international environment shall define for their companies and what kind of future trends it forecasts for this important sub-segment of the East-Central European automotive industry.

The study is based on data taken from the Slovak, Hungarian and Global CEO Survey of PwC, the world's leading professional services firm, which was made globally the sixteenth, in Hungary the second, and in Slovakia, in cooperation with Forbes Magazine, the fourth time. Every year, these surveys aim at providing an opportunity to summarize the opinion of the most important representatives of the industry, the issues they are concerned about, as well as their major plans for the future. Researches are made by PwC's experts by means of telephone or personal interviews, as well as by online survey. Last year, totally 1,330 executive officers globally in 68 countries expressed their opinion on the most important areas of the business life. In addition to the global research, totally 171 companies participated in the survey in Hungary, and 180 CEOs shared their opinion with us in Slovakia.

In the automotive industry, a narrower target group of the study, 90 companies took part in the research worldwide, 29 companies in Hungary and 19 companies in Slovakia. Although the above figures do not represent a considerable size as compared to those of the participants in the global survey, we can nevertheless consider the results as an important indicator, since they reflect the opinion of the CEOs of the most important players of the industry<sup>2</sup>. The present study was made in the professional cooperation between the automotive industry experts of PwC Hungary and Dr. Vendel Lőr, senior lecturer of Széchenyi István University.

2 The figures indicated on the charts do not add up to a total of 100% in every case, as we rounded up percentage data and did not include the answers "Neither agree nor disagree" and "Don't know" in our calculations.

1 According to PwC industry classification first of all the car manufacturers, the OEMs (Original Equipment Manufacturers) and their suppliers as well as the automotive manufacturers in general (it means consequently the truck and machine producers etc.) as well as the vehicle dealers are classified as automotive companies.





## 1. Automotive trends in the East-Central European region

Nothing shows better the emerging role of the Hungarian or the Slovak automotive industry than the fact that news are published almost daily in the press concerning automotive factory extensions, greenfield investments as well as the improvement of the supplier network related to the automotive industry. In order to compare the automotive industry of the two countries under review with the position of the international players, we need to clearly see the role of the East-Central European automotive industry in the global economy.

Europe is the second most important region of vehicle and engine manufacturers after Asia. Six million persons have direct subsistence in Europe from the automotive industry and further twelve million are indirectly connected to the sector. The importance of the automotive industry on the “old continent” is rightly shown by the fact that 3 percent of the European GDP are provided by this industry<sup>3</sup>.

So, the question is what share the wider environment of the two countries, i.e. the East-Central European region shall have within the European automotive industry. Statistics confirm that large quantities of both vehicles and their components are manufactured in the region. Based on the statistics of 2010 it can be stated that the European automotive production is moved towards the Eastern regions. While in 2000 eight of ten cars came from production line in Germany, ten years later this ratio was only 64%. All in all, the significance of the Czech Republic and Slovakia was principally increased in the region<sup>4</sup>. It shows the importance of the automotive industry that it runs to appr. 3.9 percent

of the GDP in Hungary (moreover, taking the suppliers and relating industries into consideration it amounts to 10 percent<sup>5</sup>) and to 6.7 percent in Slovakia<sup>6</sup>.

But what do the above figures mean when interpreting them for industrial trends? It can be seen that a restructuring process occurred and is occurring in the European automotive industry even today. Primarily, the relocation of companies producing well-known automotive brands and basically assembling their units, i.e. the so-called OEMs (Original Equipment Manufacturers) as well as of the supplier network mainly to the new member states of the Union can be observed. The determining factors of the relocation are the OEM companies, then they are closely followed by the suppliers, led by the so-called integrators or first round suppliers and then, they are followed by the second and third round suppliers. So, the top of the pyramid is built typically first, and then, the base will also start to grow organically.

It can be clearly stated that, due to the restructuring in the automotive industry, the East-Central European region has been the great winner of the 2000s. However, the different countries participated in the relocation of the automotive industry to varying degrees: the two most extreme examples offer Slovakia and Hungary. Slovakia has increased its significance two and half times in the East-Central European region, and in 2010 it provided round 6 percent of the automotive production in the region. Although Hungary has also increased the automotive production in an absolute value, its relative position has

not changed essentially; it amounted to 1.8 percent in the East-Central European region in 2010. It means globally that Slovakia provided 0.8 percent and Hungary 0.2 percent of world production. On the other hand, it serves for the advantage of Hungary that several large investments arrived at the final stage simultaneously with the study (i.e. enlargement of the Audi factory in Győr as well as launching the serial production of Mercedes), so these ratios will considerably be changed within 1 or 2 years as described in the subsequent chapters of the study.<sup>7</sup>

So, the question is, what is the reason for the strong east-west movement of the automobile industry. The most important factor is undoubtedly lies in the difference in wage costs. It is true that the wage costs have a share of only 10 percent within the costs of the ready-made automotive, and what is more, this ratio is merely six to eight percent within the premium category vehicles, but, due to the differences in the wage levels these savings become significant for the automotive companies in the extent that the capacity expansion is worth in the emerging countries of the East-Central European region. However, the wage costs represent only one side of the question, since keeping the logistic costs low hinders the relocation to geographically distant regions. In addition, it should not be disregarded that the work culture of the studied countries is considerably advanced, and the automotive industry has traditions which means that the “soft” human factors are also available. The relatively favourable infrastructure and the potentially obtainable state subsidies are

also attractive for the OEMs and for the suppliers of lower level typically settling in the second phase.

A kind of competition, primarily for the extension of greenfield production capacities, can be experienced in the countries of the East-Central European region. In terms of attractiveness, Hungary and Slovakia is approximately at the same level, while the Czech Republic and Poland are considerably ahead on the basis of indicators calculated on the basis of complex economic factors.<sup>8</sup>. Among the location factors, the professional skills, the innovation potentials and the R&D capacities have an outstanding role. Industry experts are of the same opinion that the automotive production accumulates a huge mass of knowledge, which will have an increasingly high role in the future. In this mass of industrial knowledge, the intellectual added value of the suppliers becomes more and more important, moreover, it is characterized by the tendency that recently the significant innovations appear not only in premium but also in lower price categories. Consequently, the question of tomorrow is for the automotive companies of the East-Central European region if they can manage to increase the added knowledge value or the economic players in the region stuck in the group of countries competing by low wages<sup>9</sup>? The knowledge embodied in qualified professionals, it means the qualification is especially of importance, since the qualified workforce is in short supply in the large automotive companies; and it may become a serious obstacle for the future development.

<sup>3</sup> Györgyi Barta (2011): European correlations of the Eastern Central European vehicle production, pp. 27.

<sup>4</sup> János Rechnitzer – Melinda Smahó (2012): The effect of the vehicle and automotive industry on the competitiveness of the Eastern Central European region, pp. 7.

<sup>5</sup> According to the estimation of the Hungarian Automotive Association (2012)

<sup>6</sup> Own calculation, based on the data retrieved from ksh.hu and statistics.sk

<sup>7</sup> János Rechnitzer – Melinda Smahó (2012): The effect of the vehicle and automotive industry on the competitiveness of the Eastern Central European region, pp. 7.

<sup>8</sup> Anita Füzi – Szandra Gombos – Tamás Tóth (2011) Location factors for automotive companies in Eastern Central Europe

<sup>9</sup> Melinda Smahó (2011) Systems of knowledge transfers and the automotive industry

## 2. Review of the Hungarian automotive industry

Hungary and Slovakia are essentially in similar position in terms of attractiveness to the automotive companies. This is confirmed by the fact that neither the wage ratios nor other location factors differ considerably from each other. The similarity of the wage level in the automotive industry is indicated by the fact that the wage of the manual workers of the industry amounted to 718 EUR/month in average<sup>10</sup> in Hungary in 2011, while the average wage in Slovakia totalled e.g. in machine operator job 599 EUR, in body painter job 695 EUR and in body ironer job 758 EUR. The fluctuating exchange rate of the forint, the disparities arising from the regional differences as well as the different categorization of the statistical data have considerable influence on the apparent difference<sup>11</sup>. Several researches have also investigated the factors influencing the the automotive manufacturers and suppliers to settle down, and on this basis, it is obvious that there are no no essential differences between the two countries: according to a ranking made by the Business Monitor, Slovakia ranked to the 9th and Hungary to the 11th place in the rankings of business environment.<sup>12</sup> The Hungarian researchers came also to similar result: Hungary ranked to the 32nd and Slovakia to the 39th place in the assessment of the business environment of the automotive companies.<sup>13</sup>

<sup>10</sup> Calculated on annual average rate of 279 EUR. At 300 forint/EUR exchange rate the mentioned average wage amounts to only EUR 669.

<sup>11</sup> In Hungary there are huge regional differences in the average wage level of the automotive industry; a good example is that the average wage of blue-collar workers in Western-Transdanubia is exactly the double of those in South Transdanubia. (<http://www.ksh.hu/docs/hun/xftp/idoszaki/region/gyorgipepar.pdf>, as well as [http://www.sario.sk/userfiles/file/Ensario/PZI/sectorial/auto/automotive\\_industry.pdf](http://www.sario.sk/userfiles/file/Ensario/PZI/sectorial/auto/automotive_industry.pdf))

<sup>12</sup> Business Monitor (2012) Slovakia Autos Report, Q1 2013

<sup>13</sup> Anita Füzi – Szandra Gombos – Tamás Tóth (2011) Location factors for automotive companies in Eastern Central Europe

The OEMs settled by a greenfield project represent the basic pillar of the Hungarian automotive industry. In respect of the added value illustrating well the economic role, the Audi Hungária Motor Kft. in Győr is the most important link in the Hungarian automotive industry. Audi becomes a determinant player primarily in the field of the engine production and secondly in the field of the complete automotive production due to an automotive factory ending in 2013 as well. Much behind Audi, the Suzuki factory in Esztergom is also a significant player of the Hungarian automotive industry in respect of value-added production cabability. Considering the number of employees, the manufacturer employs 2800 employees at present. Currently, the company cannot utilize its production capacity developed up to 300,000 motor vehicles in 2008, since the sales of the typically low and medium category automotives belonging to the factory's profile suffered most in the crisis period. An increase in the production of the large vehicle

brand Mercedes settled in Hungary at the latest was experienced at the end of 2012 making its economic impact felt from this year onwards. The factory's nominal capacity amounts to about 100,000 motor vehicles, which can make this player a significant pole of growth in the region of Kecskemét by the expected development of the suppliers' network.

In respect of the production, the Rába Group seated in Győr is considered a respected and prestigious player in Hungary; according to data from the end of 2012 the number of its employees totalled 1,939 and its sales revenue exceeded 135 million EUR. Within the operational profile of the company, the running gears market is strategically decisive ensuring nearly 60 percent of the revenue. In addition, the company's market portfolio includes the vehicle parts and complete vehicle production.

Again, a considerable automotive capacity is represented by the motor factory of Opel Szentgotthárd Autóipari

Kft., which, as projected for 2013, set the production of 336 thousand motors as an aim; and employed nearly 1,300 workers at the end of 2012.

As it could be seen from the list, the OEM producers have developed considerable production capacities in Hungary, but further significant growth can be expected in 2013, because the statistical data will show the increase in the production only from this year.

Comparing the automotive production capacities in Hungary-Slovakia dimension, we can say, while Slovakia has nearly tripled its automotive production capacity in 10 years until 2010, Hungary was only able to increase the number of vehicles manufactured from 137 thousand to not more than 168 thousand. Based on the statistics of the two thousand ten years even the Hungarian data show an imposing growth thanks to the mentioned new large investments resulting in the increase of vehicle production capacity to 525 thousand pieces by 2013.

On the other hand, a considerable supplier network can be connected to the primary producers in Hungary, too. It is generally known that the large international producers are overall not excessively strongly integrated in the economy, or rather the Hungarian supplier network was not yet able to intensively join in the division of labour. It is true that the producers have different parameters: Suzuki has currently an estimated 30 percent of domestic supply ratio, while Audi and Opel have 5% ratio each. All these mean that the Hungarian supplier network is advanced in regional respect but compared to the West-European standards it is still rather underdeveloped.<sup>14</sup>

<sup>14</sup> Mátyás Klauber (2011) Elaboration of strategy on the strengthening of the supplier role of the Hungarian small and medium sized enterprises in the mechanic engineering and the automotive industry sector

The trends of the Hungarian supplier network reflect typically the global trends, i.e. a multi-level (3 to 4 levels) network was developed also here where the international first round supplier companies can only be first involved. The Hungarian enterprises are basically present at the second, third or lower supplier levels. On the other hand, it also creates the problem that the Hungarian-owned companies are at levels of lower profitability and they are in majority not able or hardly able to launch improvements that can incorporate higher added value in the components because the rollover of the profit is insufficient for the progress.

The so-called clustering process is taking place in the Hungarian automotive industry still today and as a result the industrial enterprises can make use of the advantages arising from the geographical nearness and the existence of a critical mass. The automotive clusters embrace not only enterprises belonging closely to the industry but also the players of supplementary industries, e.g. logistic, engineering design or consultation companies that can develop profitable business relations. The clustering process has furthermore the outcome that the great mass of companies represents sufficient demand for the supply of qualified junior professionals considered otherwise a problem area. This provides a proper attraction for the institutions of higher education and for the continuation of studies so that the replacement and training of professionals can be supported. However, the clustering process may facilitate the development of the sector not only in these fields but the automotive companies, as a kind of pole, may attract the research and innovation capacities of the region, which may improve the chances of the Hungarian suppliers and increase the share of the domestic supplies of the OEMs. For this reason, it is extremely

important how the institutions of higher education can join in the companies' R&D processes and in the replacement of professionals In this field, we can meet exemplary cooperations, typically in institutions of higher education providing technical education. The Regional University Knowledge Center for Automotive Industry in Győr or the Audi Department Group seated also in Győr at the Széchenyi István University should be mentioned by all means. Audi and Rába implement a similarly close cooperation with the Budapest University of Technology and Economics as well.

It can be ranked as the strength of the Hungarian automotive industry that the production of the automotive components is well-founded, the production is cost-effective, and the foreign-owned companies produce efficient operation<sup>15</sup>. The commitment of the key players is increased by the fact that they invested considerable amounts in the industry, furthermore, the ratio of the labour costs compared to the qualification level remained advantageous within the Central East European region in spite of crisis effects.

The importance of the primary producers and that of the automotive suppliers is well indicated by the fact that even in the weakest business year of the crisis, in 2008 the automotive industry had a share of 45.4 percent within the sales of the processing industry while producing an added value of 2.8 billion EUR; the total sales of the automotive industry amounted to 13.7 billion EUR. In 2009, the sector employed totally 115,000 persons. It can only be estimated but the investments launched at the beginning of the 2010's will considerably strengthen these ratios after the startup period, clearly indicating that beside Slovakia, Hungary will become a major automotive power at European level at least.

Key OEMs in Hungary<sup>1</sup>

Corporation	Headcount in 2013 (person)	Net revenue in 2011 (million EUR)	Value added in 2011 (million EUR)	Volume of production
Audi Hungária Motor Ltd.	8888	5.582	1.214	1.916 thousand engines (2012) 125 thousand vehicles (2013)
Hungarian Suzuki Corporation	2824	1.581	148	172 thousand vehicles (2011)
Mercedes-Benz Manufacturing Hungary Ltd.	3182	Not authoritative	Not authoritative	Capacity of production of 100 thousand vehicles
Opel Szentgotthárd Automotive Ltd.	1292	76	46	336 thousand engines (2013)
Rába Automotive Holding Plc.	1939	135	32	

<sup>12</sup> Composed on the basis of the National Tax Authority's database, press news and company reports

## Features of the Hungarian supplier network

In 2012-2013, the Research Group for Spatial Economics and Automotive Industry at Széchenyi István University (JÁTÉK) performed an in-depth survey among the Hungarian automotive suppliers. During the research, the experts visited totally 119 enterprises connected with the Hungarian automotive production, using a questionnaire data record and deep interview methodology, and mapped the economic and operational features of the network, the depth of the network, the integrated status of the companies, the strategic goals and the management methods applied as well as the innovative characteristics.

Three-fourth of the sample was composed of companies from the sector of the small and medium-sized enterprises, and within it, one-third of the sample was constituted by companies with sales revenue between 50 and 500 million HUF. The results of the research confirmed that, in addition to the company size, the ownership background is the factor mostly influencing the business operation of the suppliers. In breakdown by circle of suppliers, nearly half of the companies participating in the research were composed of second round suppliers and, in addition, further 30% belonged to the first round suppliers.

The main trends include that, in business sense, the quality, price and the flexible delivery represent the major success criteria of the suppliers, while the R&D or the innovation will be considerably subordinated for the time being. For the objective interpretation of the results, it must be noted that the higher portion of the sample (70%) was composed of second round or lower level suppliers. The higher level suppliers are studied, the more typical is the innovation. Besides, it shall also be noted that the CEOs interpret the triumvirate of quantity, price and flexibility as a kind of minimum condition where R&D, innovation and cooperation are rather included among long-term success factors. Furthermore, it is also characteristic that the relationship with the players acting within and outside the industry (e.g. universities, research points) is random and occasional. A typical result is that the relations directly convertible into cash e.g. the university capacities and professional supply have a priority within the CSR.

Although, in respect of operation, the roots of strategic thinking are traceable but the strategies are typically prepared by involvement of a narrow circle. On the other hand, the larger company size and the foreign ownership background may influence the advancement of the strategic thinking.

As to the business policy, in addition to the trends mentioned before, the strong customer defenselessness is typical; and the follow-up attitude characterizes both the prices and the business operation. The existing customers, the market and the extension of the potential product range are main driving force of the operation and growth, though the role of the cooperation and innovation look small beside them but they cannot be ignored.

Although 90 percent of the companies indicated that they conduct certain innovation activities in economic sense but, in majority, the innovation is of secondary importance for the average Hungarian supplier of the 2010 years and so neither the strong customer pressure can be eased nor the profitability can be improved.<sup>16</sup>

<sup>16</sup> Melinda Smahó – János Rechnitzer (2012) *The automotive industry supplier network in Eastern and Central Europe and Hungary*



### 3. Review of the Slovak automotive industry

The Slovak economic development is interwoven with the development of the automotive industry, which can be properly traced by the similarity between the rate of change of the GDP and the conjunctural rhythm of the automotive industry. As from 1993, the inflow of Foreign Direct Investment started almost from null. The economic policies of the early 2000s recognized the rapid growth potential of the focused economic development. The unconcealed aim of the focused economic policy was to develop the automotive industry to become nationwide the basis for the economic prosperity and modernisation. Nothing proved this better than the automotive industry attracted 17 percent of the Foreign Direct Investment in the 2000s and in this context metalworking (7%), automotive (16%) and chemical industry (13%) became the main target of the foreign investments.<sup>17</sup>

From point of view of the automotive industry, Slovakia started with, and still has, similar competitive advantages as the other East-Central European countries: fundamental factors were for the location the relatively low wages and raw materials as well as the low level of the energy costs in addition to the favourable geographical location. The importance of this latter as well as the positive economic benefits of the fixed-line infrastructure shows that primarily the Western region of the country attracted the OEMs followed by the supplier network. The axis of the Slovak automotive industry is based on three greenfield automotive investments: the factory of the Volkswagen Group in Bratislava, the factory of PSA Peugeot-Citroën in Trnava and that of Kia in Zilina. The significant part of the industrial production is connected directly to these three factories or indirectly through the supplier network.

The factory of VW started its operation in the early 90s and became the largest manufacturing company of the country; in 2004, for example, 20 percent of the total Slovak exports originated from here. Establishment of the factory in Bratislava gave a boost to the development of the automotive supplier network: the sales revenue of the supplier network became tenfold higher by 2008, i.e. it run to 9 billion EUR that year. Of course, as from 2006, the factories KIA and Peugeot-Citroën have actively participated in the growth of the sector. As to geographical location, the suppliers appeared in the agglomeration of the large automotive factories as well as in Kosice, mainly as a result of the greenfield projects of the three OEM companies mentioned above.

Within the structure of the supplier network, the first level suppliers are typically the subsidiaries of foreign-owned corporate enterprises. Among the second round suppliers the Slovak-owned companies are already present, however, the majority of nationally owned companies operate at the third level of the supplier pyramid. The majority of suppliers can be grouped into five categories according to the scope of activities: electric systems and cables; production of interior fittings of motor vehicles, driving gear and exhaust system, bodywork as well as other drivers.

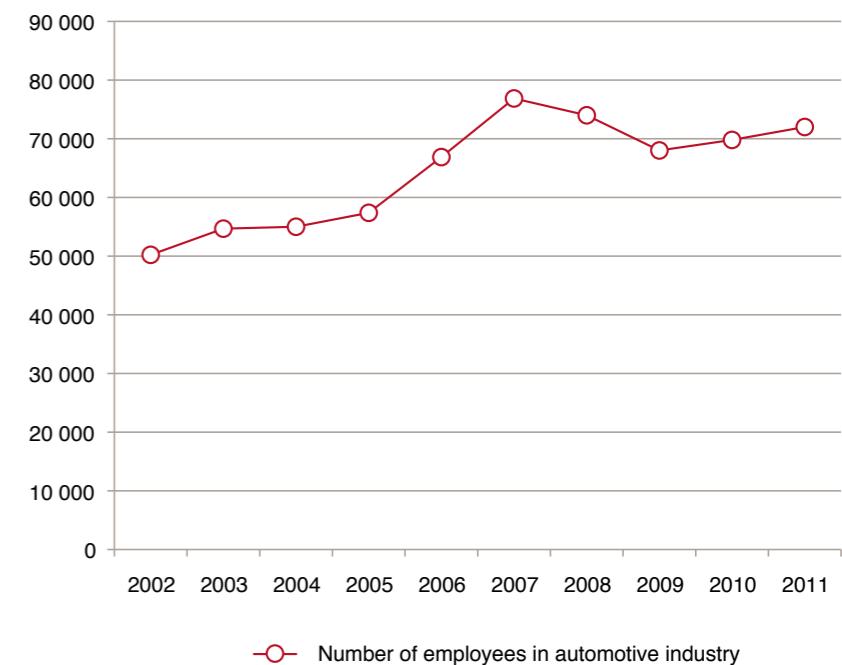
Slovakia became one of the leading automotive producers in East-Central Europe, due to the appearance of the three OEMs and the development of supplier network based on them. In figures it means that in 2010, the number of those employed in the automotive industry, following a slight decline, exceeded the threshold of 70,000 persons again, which totals somewhat more than 3 percent of the total employment. The importance of the sector is proved by the fact that the volume of somewhat less than 200,000 motor vehicles produced in 2001 was increased to 900,000 by 2012, while the performance of the companies has considerably decreased in the crisis period. According to industry forecasts, the volume of the Slovak automotive production shall continue to increase in the future.<sup>18</sup>

Considering the automotive attractiveness of Slovakia, the competitiveness relying upon cost advantage shall be increasingly replaced by the product innovation process, the increase of knowledge value added as well as the integration of the local R&D into the value chain. This strategy shall increasingly prepossess the whole the supplier network. This process is well characterized by a growing trend of clustering where the research institutes and universities take also part in the development. The cooperation between Volkswagen and the Slovak University of Technology is exemplary, or launching of new professional courses providing soil for engineer training for the automotive companies is also worth mentioning. PSA Peugeot-Citroën supported the establishment and equipping of professional laboratories in joint cooperation with the university sphere.

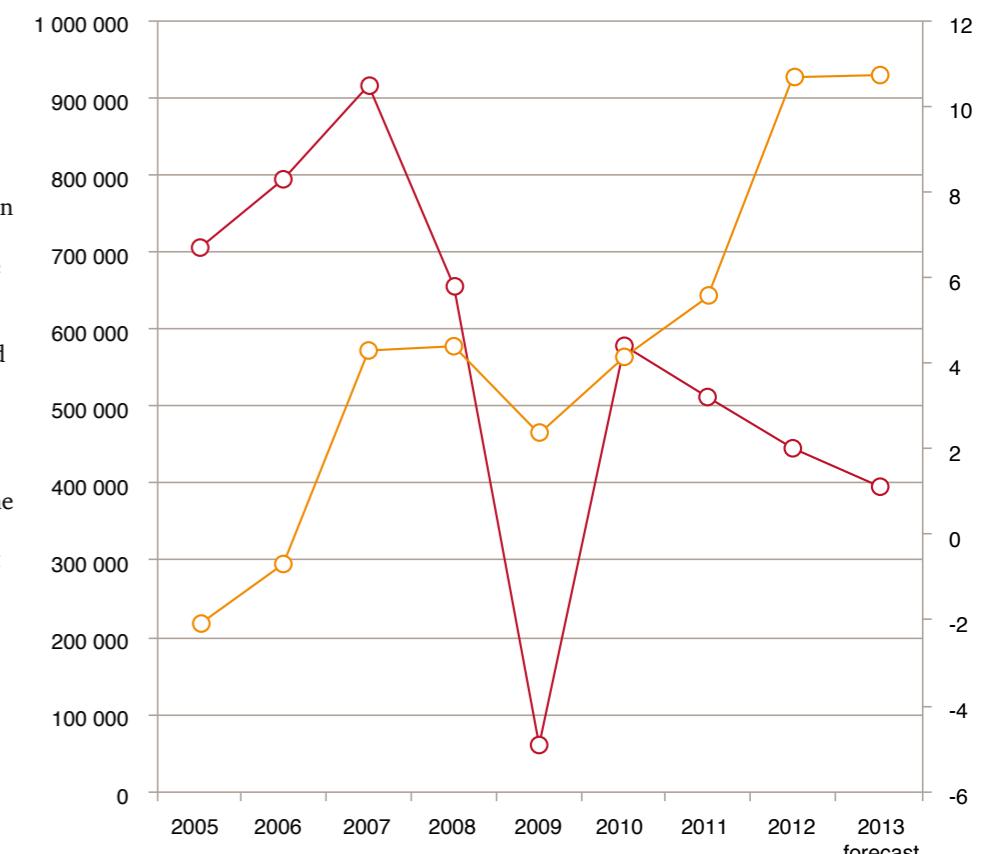
The strengths of the current Slovak automotive industry include the favourable location and the still relatively low labour costs but the knowledge elements encountered increasingly shall be also integrated in the value chain offering attractive conditions for the suppliers. However, for the time being, the education system needs improvement: the cooperation in research between the university and the private sphere and the outdated equipment of the universities belong to the weaknesses of the Slovak automotive industry.<sup>19</sup>

The industry raises the question how much the strongly export-oriented and concentrated Slovak industry based basically on three big factories, one of them is the pillar of the automotive industry, represents a stable base for the country's economy. One of the shady sides of the Slovak economic policy became visible during the crisis period: in other words, the crack of the automotive industry shall have drastic impact on the growth of the country. It is clear that the decline cannot be prevented totally but the increase of a knowledge-based added value and the integration of the supplier network can probably retain the OEMs in the country. Although the Slovak automotive industry confronts backlogs in the business operation compared to the Western countries, the companies seem to have recognized that the enlargement of the added value of knowledge (R&D) at both supplier and OEM level can be a guarantee for development.

The Slovak automotive industry in figures



—○— Number of employees in automotive industry



—○— Volume of vehicle production (pieces)

—○— Economic growth (%)

<sup>17</sup> Zoltán Kovács (2011) Analysis of the Slovak automotive industry

<sup>18</sup> <http://www.zapsr.sk>, download: 22.03.2013 10:08 a.m.

<sup>19</sup> Zoltán Kovács (2011) Analysis of the Slovak automotive industry

## 4. Prospects for growth

*Albeit the international automotive industry had worse prospects for 2012 and 2013 than other sectors had, the automotive industry was among the over-performers in Hungary and Slovakia in 2012 and, considering the prognosis of CEOs, it will likely continue to keep its driving power. In the economic stagnation and the take-off period both Slovakia and Hungary are able to increase their importance in the automotive industry.*

The results of the CEO Survey of PwC complement excellently the statistical data presented at the automotive industry panorama of Slovakia and Hungary, since the development trends as previously drawn by 2012 are expanded by updated first-hand information as well as tinged by the latest trends.

2012 was a year of after-crisis stagnation both in Hungary and Slovakia. There are important macro-economic differences between the two countries, let's simply think of the official local currencies or the national debts. Consequently, Slovakia performed proportionately better in relation to the economic growth: the member states of the European Union essentially stagnated; in Hungary the GDP declined by 1.7 per cent, while in Slovakia a slight increase (2%) could be experienced. Within it, the results of the CEO Survey throw light on how differentiated the sectors were affected by the recession of the economic environment: it is especially worth of attention that 52% of the Hungarian automotive companies reported an improvement in their position in 2012 compared to the ratio of 41 percent for the sector-neutral players. Based on the data, the automotive industry has smarted less the last year. Independently of the industry only 17 percent of the Hungarian companies reported an

improvement in the domestic market, and 53 percent experienced recession. This is primarily due to the government measures taken for the reduction of the fiscal deficit. A well-known process among the economic analysts is how the possible tax increases implemented for reducing the budget deficit and the reduction in government purchases restrain the economic demand. The companies had promising performance on the foreign markets in 2012: in the opinion of 42 percent of the automotive companies, the export opportunities became better. This ratio does not differ considerably from the opinion of the players of the other sectors (45%).

The relatively better results of the automotive industry are not surprising in respect of the economic activity, since the motor vehicles are high-quality durable consumer goods, it means that the production data are good indicators of the economic numbers. A second segment of the automotive industry, namely the production volume of trucks works expressly as a cycle phase forecaster. Consequently, it is not surprising if we compare the prognosis of not only the Hungarian but also the global automotive industry segment concerning the past years with the figures of other sectors: at global level, the economic prospects forecasted by the CEOs of the automotive companies for the forthcoming years indicated, from year to year, extreme swings than in the case of all other sectors. This is well illustrated also by the PwC Global CEO Survey of last year. The results confirm that the automotive industry shows a strong cyclical character, fundamentally determining the prospects of the Hungarian and Slovak sectoral companies as well.

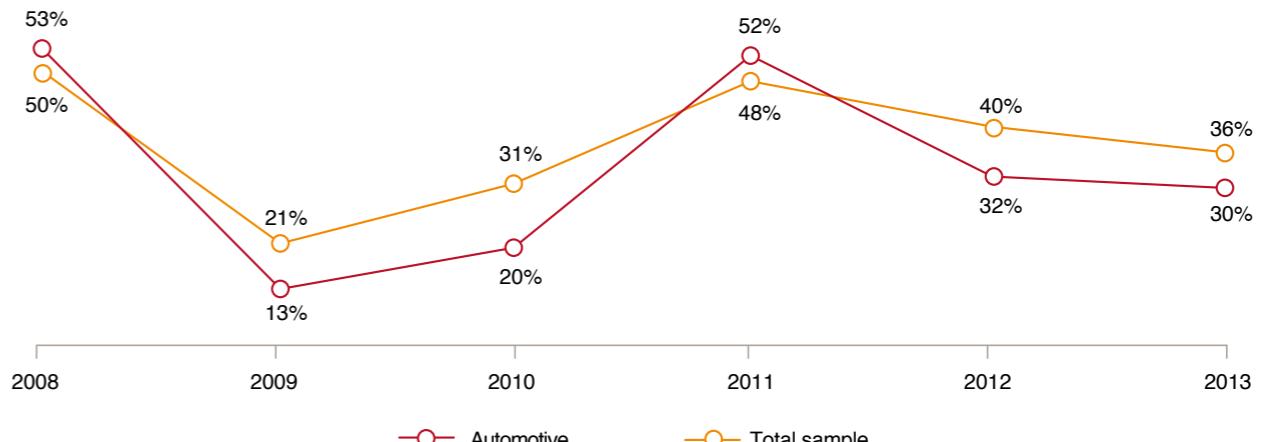
Independently of the industry 36 percent of the CEOs and globally 30 percent of the CEOs in the automotive industry are confident in the increase of the revenue of their own company. Independently of the industry only 18 percent of the CEOs are optimistic; this ratio is a little bit higher in the automotive industry, it totals 21 percent. These figures fairly reflect the general weakness of the Hungarian growth prospects that has a negative effect also on the automotive industry. In Slovakia, the short-term prospects of the CEOs of the automotive companies are somewhat more favourable; 26 percent of the companies stated that they were strongly confident in the growth of the sales revenues.

The short-term trends are further nuanced by the opinions about the development of medium-term company revenues. The Slovak automotive industry is the most confident in the medium-term prospects, followed by the Slovak sector-neutral sample. In this respect, the Hungarian automotive industry is greatly ahead of the global automotive industry, and finally the Hungarian sector-neutral sample has the weakest perspective. This fairly reflects the CEO opinion that the Hungarian economy faces lower growth prospects but the automotive industry can be still the driving sector in Hungary, presumably partly due to the efforts of the government and partly due to the expected world market growth.



### Prospects of the automotive industry over the past years

Q: How confident are you about your company's prospect for revenue growth over the next 12 months?\*

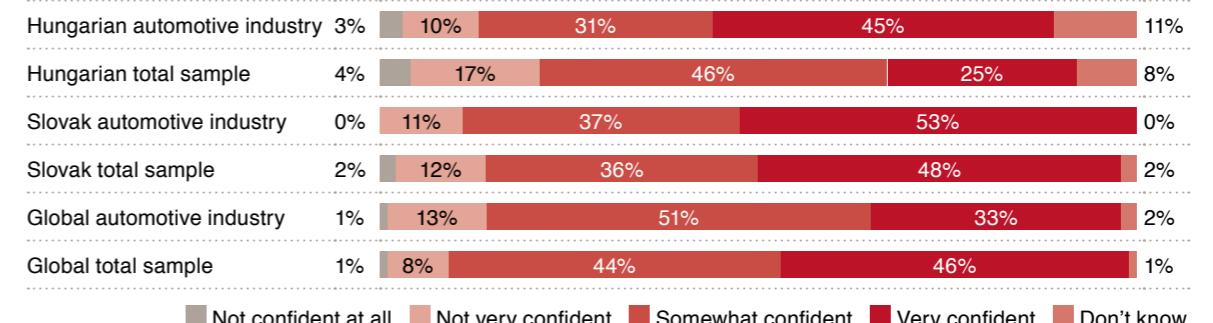


\* Percentage of responders who are very confident about their company's growth prospects

Source: PwC's 16th Annual Global CEO Survey

### Mid-term perspectives for the automotive industry

Q: How confident are you about your company's prospects for revenue growth over the next 3 years?

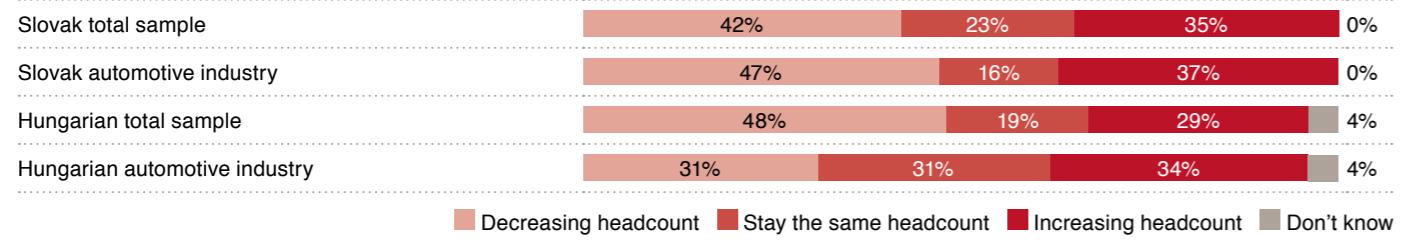


Source: PwC's 16th Annual Global CEO Survey, 2nd Hungary CEO Survey and Slovak CEO Survey 2013

## 5. Risks of the business environment

### Changes in headcount (2012)

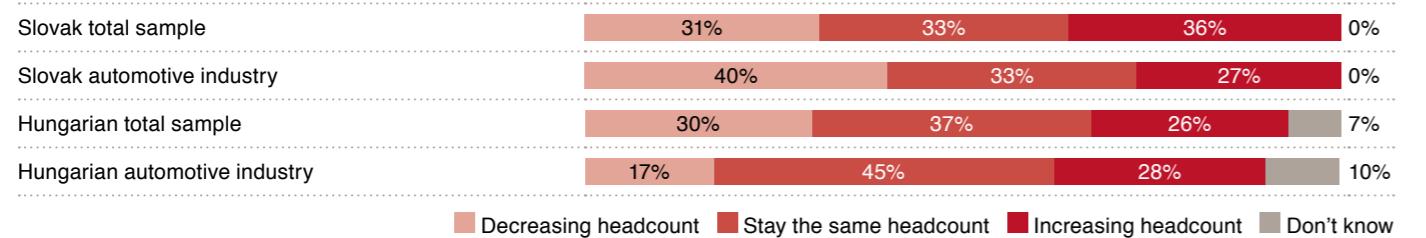
Q: What happened to the headcount in your organisation over the last 12 months?



Source: PwC's 2nd Hungary CEO Survey and Slovak CEO Survey 2013

### Expected changes in headcount (2013)

Q: What do you expect to happen to the headcount in your organisation over the next 12 months?



Source: PwC's 2nd Hungary CEO Survey and Slovak CEO Survey 2013

Investments can be considered as the lights of the economic growth: the corporate investments not only predict but often form the economic activity as a self-fulfilling prophecy and therefore, it is advisable to analyse the automotive industry also from this point of view: 62 percent of the players in the Hungarian automotive industry plan a significant investment in 2013. Independently of the industry this ratio totals 52 percent in the whole sample. The intention to invest confirms the previous statement that the Hungarian automotive companies are, in spite of the unfavourable trends, in a better position than the players in other sectors. On the other hand, these figures point out that the company management projections are rather pessimistic than those reflected in the actual company activity.

In addition to the results, involving projections and investments, it is advisable to check whether the changes in the number of employees confirm the pessimism of the CEOs or rather reflect the optimism experienced at the investments. The dynamics of the

employment figures in the automotive industry show that the automotive companies were forced to rationalisation much rarely (30%) than the Slovak competitors (47%) in 2012. The Hungarian companies typically worked with a stagnating headcount instead of rationalisation, and the ratio of growing companies is practically similar in both countries (37% and 39%).

It is interesting that the more pessimistic market prospects and the more negative judgement of the year 2012 were not reflected in the rationalisations in Hungary. Probably, the higher corporate operating reserves and the previously enforced rationalizations may have played a role in this non-reflecting.

The prognosis of CEOs for this year shows a similar pattern as compared to those of 2012: the players of the Slovak automotive industry plan considerable dismissals (40 percent of the companies), while their Hungarian competitors count on a much lower rate of rationalisation (only 17% plan dismissal). These trends are however difficult to be explained

in the light of the fact that the OEMs implemented a significant increase in the production in Slovakia in the past years, while in Hungary an increase in the production is expected for 2013, among others in the factories of Audi and Mercedes. Most likely, the reason for the somewhat paradox results is that the companies well adaptable to the environment were able to grow but there are players belonging to laggards and are forced to count on stagnation or decline.

Studying the charts it is visible that the Hungarian automotive companies figure on a stagnating headcount instead of rationalization for this year; the ratio of companies forecasting an increase in headcount is essentially the same in both countries (27% and 28%). Nevertheless, it shows a stronger uncertainty in the Hungarian economy that 10% of the CEOs are not able to forecast their headcount figures, while in the Slovak sample all CEOs were able to prognosticate the direction of changes at least.

*The evaluation of the economic and political risks in the automotive industry reflects the general fears of the Slovak and Hungarian economic players. Partly world economic trends and partly country-specific effects are manifested. The automotive industrial specificities are not significant in this question. Most of the problems are caused typically by the economic growth, the fear of budget adjustments and the increase in tax burdens for the CEOs of the automotive companies. The automotive trends are already manifested much stronger for business risks: the most dynamic threat is the shortage in resources. The major competition factors are the energy prices – similarly for the global players – and the knowledge resource – mainly as regional characteristics.*

From among the macro-economic risk factors, the Hungarian automotive companies regard, at nearly the same rate, the inflation (62%), the uncertain economic growth (62%), the exchange rate fluctuations (62%) and the possible restrictive government measures (65%) as main sources of risk. The Hungarian CEOs seem to be more afraid of the macro-economic changes than the

automotive companies. This projects a relative less troublesome environment for the CEOs due to the strong export-orientation of the automotive companies and the supposed better performance of the external markets. The conclusion is justified since the enterprises consider the economic growth and the threat of government measures much less critical factor, and altogether they mean that the protectionism of other countries is much more a threatening risk for them.

The Slovak automotive companies consider the macro-economic environment relatively more threatening than their Hungarian competitors: the former are afraid of the uncertain economic growth (100%), the restrictive government measures (94%), the capital market instability (79%) and the protectionism (75%) at most. It is visible that the uncertain economic growth and the economic policies restraining the state budget deficit are sources of risk in both countries, but the country-specific factors play a role: The problems are caused in Hungary by the inflation and the exchange rate fluctuations, while in Slovakia, by the protectionism confining the external markets and the capital markets.

Similarly to the political and economic risks, the Slovak automotive companies assess almost all market and business factors more risky than the Hungarian competitors. In Slovakia, the fast changes in consumer habits (74%), the increase of energy costs (74%) and the lack of key capacities (73%) are on the top of the risk factors. The possible drastic increase of energy prices also represents a considerable threat in the global automotive industry, which can be explained by the composition of cost structure of the sector in the automotive industry. It is remarkable that the comparison of the total Slovak and Hungarian sample in addition to the automotive industry indicates a more sensible risk assessment in Slovakia.

In the Hungarian automotive industry, the access to the key capacities (62%) and the potential changes in the energy prices (59%) are on the top of the list. The Slovak and Hungarian data show that the key capacities, involving fresh supply of professionals represent a bottle-neck in the sector appearing as threats for the companies. Reviewing the East-Central European region this confirms the statements concerning the professional trainings and supply of professionals.

### Top list of the most important political, economic and business factors

Q: How concerned are you about the following potential economic and policy threats to your growth prospects?\*

	Slovak total sample (n=180)	Slovak automotive industry (n=19)	Hungarian total sample (n=171)	Hungarian automotive industry (n=29)
Inflation	41%	43%	59%	62%
Protectionist tendencies of the government	70%	75%	36%	45%
Uncertain or volatile economic growth	94%	100 %	80%	62%
Over-regulation	67%	63%	62%	51%
Lack of stability in capital markets	51%	79%	51%	38%
Exchange rate volatility	34%	58%	72%	62%
Government response to fiscal deficit and debt burden	83%	94%	84%	65%
Bribery and corruption	73%	63%	47%	38%
Increasing tax burden	91%	95%	74%	45%

Q: How concerned are you about the following potential business threats to your growth prospects?\*

	Slovak total sample (n=180)	Slovak automotive industry (n=19)	Hungarian total sample (n=171)	Hungarian automotive industry (n=29)
New market entrants	54%	35%	27%	38%
Availability of key skills	62%	73%	46%	62%
Energy costs	56%	74%	49%	59%
Security of supply chain	48%	53%	21%	20%
Permanent shift in consumer spending and behaviours	68%	74%	41%	13%
Speed of technological change	41%	47%	13%	10%
Lack of trust in your industry	45%	37%	28%	6%
Inability to protect Intellectual Property and customer data	38%	32%	10%	0%

\* Percentage of respondents who are concerned about the factor in question

Source: PwC's 2nd Hungary CEO Survey and Slovak CEO Survey 2013

\* Percentage of respondents who are concerned about the factor in question

Source: PwC's 2nd Hungary CEO Survey and Slovak CEO Survey 2013

## 6. Potential for the internal operation

*In management field, both the Slovak and Hungarian automotive companies are still behind the global automotive companies, however they are still outstanding with regard to the domestic economy. Comparing the global automotive players to the automotive players of the both investigated regions we can observe that an operative approach aspiring for short-term and direct returns dominates contrary to internal restructuring focused on strategy as well as to a long-term social participation.*

Within the scope of the management approach and priorities, there are a number of fields that can serve as indicators so that the advancement of the managerial approach and methods can be assessed. Based on the data of the CEO Surveys, we made deep surveys in several fields: we studied the strategy, the stakeholder approach as well as the corporate social responsibility (CSR) becoming increasingly important for the end consumers. Analysing the internal restructuring decisions we can see that the global automotive enterprises were much more active in the internal restructuring and organisational development activities. They are followed by the Slovak automotive companies and the activity of the Hungarian enterprises are behind them in almost every field.

In both countries and also worldwide, the cost reducing initiations were of most importance and then, on global level, the formation of strategic alliances and the "insourcing" processes were determinant. For the time being, in Slovakia the outsourcing wave is in process in both the automotive industry and in the whole economy. In the former sector 38 percent of the companies started outsourcing, exceeding even the global average. In Hungary, these kinds of decisions play marginal role, only the cost-reducing programs are typical and the decision on outsourcing was reached in some cases. Especially salient is the low ratio of the cooperation-based strategic decisions and the non-organic growth strategies (strategic alliances as well as mergers and acquisitions) in both East-Central European countries.

When the corporate strategies are checked, it is more typical for the automotive companies to work centralized than that for the players of other industries. In Hungary, 79% of the company managers are of the opinion that the risk management is made centralized (contrary to 65% of the whole sample). It means that the independence of the Hungarian subsidiaries is limited. The second strategic trend in the Hungarian automotive industry is to concentrate the supply chain: 62% aspire to establish less but reliable partner relations (contrary to 47 percent of the whole sample). This coincides with the research made by the Széchenyi István University regarding the supplier network, showing that the customer pressure is strong, and it cannot be mitigated by the diversification of the supplier companies.

It is, in general, typical for the Hungarian companies involved in the study that they focus on certain strategic initiations (67%) and only 22% admit space for free proliferation of the strategic initiations. In the Hungarian automotive industry the ratio of companies supporting the flowering of strategic alternatives, is somewhat higher (28 percent). It is typical that globally 40% of the automotive companies choose this latter strategy, which, based on the strategic management bibliography, works more efficiently in a dynamic and turbulent environment than the traditional concentrated strategy formation.

At the same time, it shows the secondary role of the information technology in the automotive industry that the companies involve the IT managers in the strategic decisions in a much less extent (only in 7 percent). In Hungary, this ratio amounted to 35% in the whole sample and this ratio was the lowest in the automotive industry with its 7 percent.

The assessment of the role of stakeholders also indicates the long-term thinking of the global automotive companies: this is, in general, more important among the global automotive players than in case of the Hungarian competitors. The difference is especially conspicuous in case of the users of social media (37 percentage point difference), the competitors (24 percentage point difference), the supplier network (23 percentage point difference) and the capital sources (23 percentage point difference). Based on these facts it can be stated that the stakeholder approach is less strong among the Hungarian automotive companies.

Among those involved it is conspicuous in case of the Hungarian companies that the employees are the first in the sequence of importance, which, at the same time, indicates that the companies strongly compete with each other for the qualified engineers and mechanical professionals in Hungary, i.e. this is such a bottle-neck that must be jointly managed by the governmental players, the companies and the local decision makers.

The corporate social responsibility means also one of the indicators of the development of corporate governance, and similarly the enforcement of the stakeholder approach. As to the corporate social responsibility, both the global automotive and the domestic players intend to increase their investments in the fields that are able to yield profit for the company in the shorter term (workforce, infrastructure).

The Hungarian companies consider the investment in qualified workforce as first priority that supports our previous statement: this area has the tightest cross section which the companies face. In areas where the return is indirect and therefore slower, the Hungarian companies are less willing to increase their efforts (climate changes, poverty reduction, stability of financial sector, protection of resources).

### Management decisions, restructuring activities in 2012

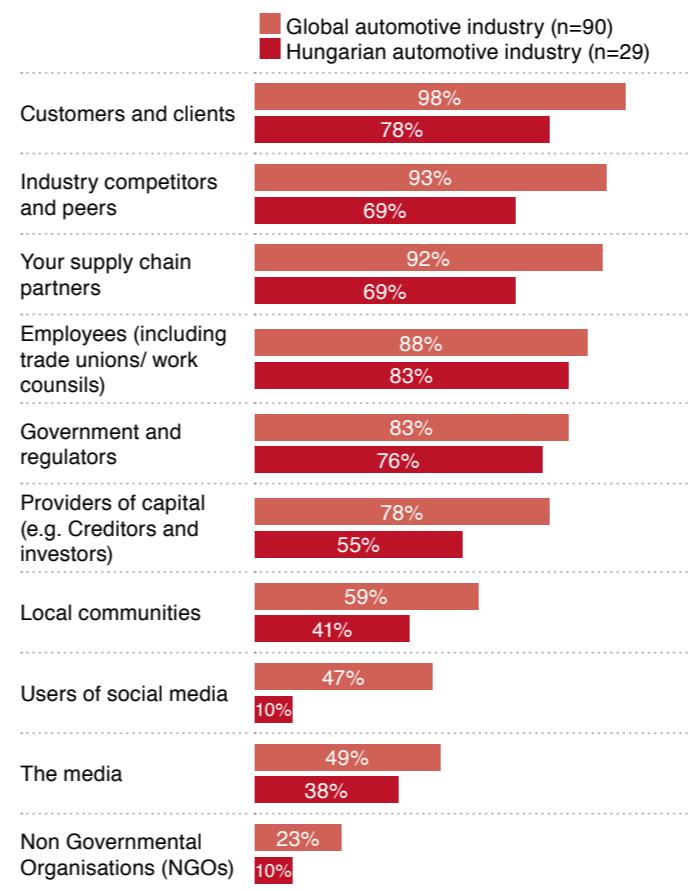
Q: Which, if any, of the following restructuring /improvement activities have you initiated in the past 12 months?

	Global automotive industry (n=90)	Slovak total sample (n=180)	Slovak automotive industry (n=19)	Hungarian total sample (n=171)	Hungarian automotive industry (n=29)
Complete a domestic M&A	18%	11%	11%	16%	3%
Complete a cross-border M&A	13%	12%	5%	11%	3%
Divest majority interest in a business or exited a significant market	12%	7%	11%	11%	3%
Outsource a business process or function	22%	38%	32%	23%	14%
Insource* a previously outsourced business process or function	26%	14%	16%	8%	3%
Implement a cost-reduction initiative	87%	87%	89%	67%	55%
Enter into a new strategic alliance or joint venture	28%	17%	11%	17%	7%
End an existing strategic alliance or joint venture	18%	2%	0%	5%	0%

Source: PwC's 16th Annual Global CEO Survey, 2nd Hungary CEO Survey and Slovak CEO Survey 2013

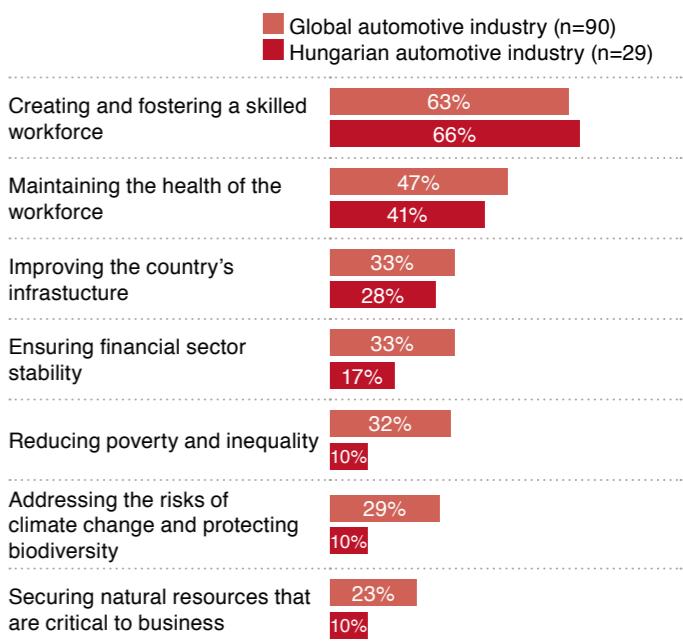
### Effects of stakeholders on corporate strategy

Q: Do the following stakeholders have any influence on your business?\*



### CSR

Q: Does your company plan to increase its investment over the next 3 years to achieve the following outcomes in the country in which you are based?\*



\* Percentage of respondents whose companies are affected by the given group

Source: PwC's 16th Annual Global CEO Survey and 2nd Hungary CEO Survey

## 7. Knowledge-based strategies

The big issue for the future is whether the CEO surveys confirm the industry experts view stating that the East-Central European enterprises move towards the era of the knowledge-based added value from the era of labour cost based competitive advantages.

However, one can see the signs that the Hungarian and Slovak enterprises move towards the innovation-based strategies: on the one hand, based on the opinion of the CEOs at both the Slovak and Hungarian automotive companies, the driving power for growth lies in the development of new products and services and, on the other hand, its imprints can also be found in the specific investment perspectives. In 2013, the investment priorities move towards the R&D and the innovative investments.

43 percent of the Slovak CEOs and 41 percent of their Hungarian sector partners are confident about the innovation of new products/services; thereby, this growth priority heads the list "with a body length" before other growth resources. It is worth mentioning that both the Hungarian and the Slovak CEOs feel more optimistic about the innovation of new products and the expansion of external markets in the automotive industry than in any other sector.

The three major priorities in the global automotive industry are: raising the level of services provided to clients, improving the operating efficiency, and increasing the number of clients. From among the three top investment targets the R&D and innovation as well extension of the production capacities enjoy priority in Hungary and Slovakia. The result confirms at the same time our previous statements that the two examined countries of the region are basically in a similar position in respect of the automotive industry; on the other hand, the increase of the knowledge-based added value will be a dominant element of growth strategies in the near future. Thirdly, it is worth emphasizing that,

The engines of corporate growth in 2013				
Q: What do you see as the main opportunity to grow your business in the next 12 months?				
	Slovak total sample (n=180)	Slovak automotive industry (n=19)	Slovak automotive industry (n=19)	Hungarian automotive industry (n=29)
New product or service development	43%	47%	33%	41%
Organic growth in existing domestic market	21%	0%	22%	7%
Organic growth in existing foreign market	17%	32%	10%	17%
New operation(s) in foreign markets	9%	16%	12%	17%
New M&A / joint ventures / strategic alliances	7%	5%	12%	6%

Source: PwC's 2nd Hungary CEO Survey and Slovak CEO Survey 2013

Investment priorities					
Q: What are your top 3 investment priorities over the next 12 months?					
	Global automotive industry (n=90)	Slovak total sample (n=180)	Slovak automotive industry (n=19)	Hungarian total sample (n=171)	Hungarian automotive industry (n=29)
R&D and innovation	34%	31%	42%	31%	56%
Manufacturing capacity	38%	17%	37%	31%	71%
Securing raw materials or components	14%	5%	0%	7%	11%
Enhancing customer service	43%	61%	32%	34%	17%
New M&A / joint ventures / strategic alliances	18%	13%	0%	13%	0%
Filling talent gaps	20%	8%	16%	10%	6%
Growing your customer base	42%	37%	32%	27%	17%
Implementing new technology	31%	32%	32%	37%	50%
Improving operational effectiveness	46%	56%	68%	48%	33%
Other	1%	2%	5%	10%	6%

Source: PwC's 16th Annual Global CEO Survey, 2nd Hungary CEO Survey and Slovak CEO Survey 2013

although the CEO projection did not show an effusing optimism, mainly in the short term, there is a chance in the mid-term in any case for growth and extension of capacities, primarily in Hungary. Probably, the rising capacities are behind all this.

## How to continue?

Although a stagnation period is experienced in the European economy and strong economic uncertainty prevails, the East-Central European automotive industry, as a whole, belongs to the winners of the recent period and, for this reason, it is in a relatively good position as compared to the other sectors. The relocation of the large automotive manufacturers to the region seems to continue, where Slovakia and Hungary will also be indicated on the world map of the automotive industry. Currently the region still has cost-based competitive advantages, and, based on PwC CEO Survey, its automotive industry is characterised by a relatively advanced business approach. Furthermore, it is of importance, that even the economic policies support the growth of the sector, since the government recognized that the sector might become a cornerstone for the convergence. It depends above all on the supplier companies whether the domestic players can manage to increase the ratio of their deliveries to the large automotive manufacturers.

The source for growth can, partly, be the development of the management thinking: for instance the stakeholder approach or the strengthening of the social responsibility. We may state that they only grant competitive advantage in the region these days but tomorrow, however, it is possible that their absence will result in competitive disadvantage to companies. The global automotive trends suggest anyhow that the long-term corporate approach and the openness are the potentials that may be an important economic factor for the future also in the automotive industry.

It is also clear where the biggest threat can be found and what is the major bottle-neck of the sector: on the short run, the automotive skilled work and the highly qualified technical experts will be the major hindrances in the sector. Its signs can be already experienced regionally. A longer-term task of the companies cannot be disregarded either.



In addition to the industry level, the survey has further message for those forming the economic policies: due to the significance of the industry in Hungary and Slovakia, it is of special importance for the purpose of both the employment and the value creation ability. The Slovak example shows, that even within a ten-year period what a major growth can the industry demonstrate, which is prioritised and properly supported by the economic policies.

*If you have any questions, comments or suggestions concerning our study, please contact us.*

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