Emerging Markets: Bullish on Automotive sector

Even as the initial signs of an economic recovery are expected to come through, the companies that have made strategic decisions during the past two years will emerge as stronger in the next boom cycle. RedSeer evaluates some of the key trends and recommend strategies that can help automobile players to emerge as winners when the demand picks up.

Auto sector has clearly been one of the worst affected because of the economic downturn. During the last two years, the demand nosedived, financing disappeared and various big names neared bankruptcy. Clearly, these were tough times for the industry and companies had to make tough decisions to save their skins.

At the same time, this situation provided companies with an opportunity to take calculated risks so that they can emerge as clear winners when the economic cycle turns for the better. For one, the sector looks promising to attract quality managerial talent that was difficult to envisage two years before. Second, companies that supported their supplier base during these times will be able to extract better value from their ancillaries. Third, companies that somehow arranged cash for capital expenditure in important projects will earn handsome returns on cash well spent.

Here are some key trends that will decide the fate of the industry within the next two years.

Increased focus on marketing and financial innovation: Indian auto sector has long been known for traditional innovation in design, process, and automation etc. But the last few years saw ground breaking innovations in financing and marketing methods. Tata Motors announced the booking of its awaited *Nano* much in advance so as to arrange for the working capital. There seems to be much greater scope for similar innovation coming from other automobile companies.

Increased focus on business intelligence and analytics: Companies such as TVS Motors have realized that a lot of value can be realized from customer/supplier data analysis. By setting up their analytics division, companies can now hope to capitalize on valuable information bank that they currently reside on.

Continued focus on cost-cutting: Cost cutting and operational efficiencies are not the words that are going to go away with the recession. This recession has provided an opportunity for the auto manufacturers to look critically at their cost structures and this mindset will serve the industry well for the coming years.

Increased involvement of OEMs with suppliers: OEMs have proven to be important strategic partners for the smaller and vulnerable auto-component manufacturers. Exclusivity clauses in supplier relationships will tend to increase as OEMs use their increased bargaining power over their suppliers.

Keeping in mind these trends, we recommend five key steps that can help automobile companies position themselves to emerge as leaders when the demand situation improves.

Tap quality managerial talent

Traditional sectors such as manufacturing have returned to be one of the major recruiters in the Ivy League campuses across the country. With innovation and analytics being major value drivers in the industry, tapping up more quality talent for mid-level managerial role will prove to be an important differentiator for the companies.

Build strong relationships with suppliers

Most auto component manufacturers have been in precarious position for the last year or so. Some have shut down their operations and others have just cut capacity. Since building capacity for the next operations is not going to be instantaneous, OEMs should clearly prioritize their sourcing strategies and start augmenting their capacity. Carefully choosing their suppliers and providing them working capital is going to be crucial.

Increase localization of the sourcing chain

There are several benefits from pursuing localization for most parts of the manufacturing chain. Firstly, it can help reduce costs in transportation and handling. Secondly, companies can be made neutral to exchange rate fluctuations. Moreover, supply chain becomes easy to manage since the lead times are generally small for localized suppliers. OEMs such as Maruti have started pursuing more localization and have reaped major benefits from the same. The hugely successful *Maruti 800* and *Alto* models now have 95% parts being manufactured in India.

More investments in flexible manufacturing and quick response systems

Flexible manufacturing systems can provide the manufacturers the much needed flexibility in managing manufacturing resources and time in this time of uncertainty. Not everything in an automobile manufacturing can be made flexible or responsive but a move towards innovation in that direction is warranted and required.

Cheaper marketing campaigns

Even though companies should never cut down their marketing expenses, but the time has come to become more innovative in running automobile marketing campaigns. Advertisements with mega movie stars may not be the most effective use of the marketing money.

SCRAP WORK

The economic scenario also gave rise to innovation not only in R & D but also in financing.

The demand situation took a more than expected beating due to the economic situation and unavailability of financing. The demand is expected to bounce back within another two quarters. The firms that have lost their supplier base will find it most difficult to revive the capacity to earlier levels. Auto-components sector has clearly borne the brunt of tightening credit for their customers.

Between the advent of this century and the onset of the economic downturn, Indian automobile industry had proliferated at a CAGR of about 18%. The fortunes of automobile industry in any country are closely tied with those of the underlying economy. This was shown by the current recession. Automobile industry is largely dependent on the spending of working class and is largely discretionary. Indian automobile industry was enjoying the five years before the recession, has been

Higher disposable income of Indian working population was a major reason for this growth.