

# Lurching Into The Fast Lane

Shripad Ranade of Tata Strategic Management Group says that small scale auto components manufacturers have many challenges staring them in the face.

The Indian auto components manufacturing sector is grappling with multiple challenges. The cyclical nature of vehicle demand and slowdown in vehicle sales, coupled with changing customer requirements and tough competition are straining margins and cash flow, and restrain suppliers from scaling up. For SMEs supplying to the Indian 4-wheeler industry, the situation is compounded by fast-changing industry dynamics and people issues. The long term prospects are bright, though, and the key is to deploy appropriate strategic options and align the organization to achieve sustainable growth.

## Effect of the Slowdown

The global economic outlook, including hitherto fast-growing economies, has deteriorated in the last year. China's growth has slipped to single digit, while the latest estimates peg India's GDP at not more than 6 percent in FY13. Western Europe continues to falter and the US is showing only a slight improvement. This economic slump has impacted India's automotive and auto component sector severely. While commercial vehicle production is more than 7 percent lower in Apr - Dec 2012 compared the corresponding period in 2011, passenger vehicle production has been flat, except for increase in utility vehicles. This has led to widespread shrinkage of order positions for component manufacturers, and resulted in underutilised capacities, margin pressures and locked-in working capital. Small and medium enterprises (SMEs) have been impacted further, due to some additional factors.

## Concentration Risk

Many SMEs are exposed to high concentration risk, being overly dependent on a single key 4-wheeler OEM or Tier-1 supplier as customer, or a single product line or sales channel. In such cases, declining market share

of that OEM has a direct, severe impact on the SME. The solution lies in selecting viable new business opportunities which can be addressed immediately, and with minimal additional investments. Options for immediate growth are:

- Tapping new sales channels such as aftermarket and retail sales, to compensate for declining OE sales (e.g. radiator parts, electrical fittings).
- Exports to additional fast-growing and sizeable export markets, for components amenable to such a channel (e.g. small forged components).
- Catering to new applications outside the automotive sector, with minor tweaks in product design and functionality (e.g. sheet metal for off-road equipment).

## Changing Priorities Of OEMs

Several SMEs have succeeded and grown in the past due to one or more privileged OEM relationship, with a high degree of assurance on orders from the anchor OEM. With increasing competition, established OEMs are willing to consider alternative suppliers to reduce cost, while OEMs entering India are willing to bring in suppliers capable of meeting their requirements. SMEs face roadblocks in adapting to these changes, in terms of scale, cost structure and product range. To align with changing procurement priorities, two specific actions can be useful:

- Operational excellence, leading to higher reliability and a lower effective cost structure and improved chances of being selected as a long-term, cost-competitive supplier going forward.
- OEMs are open to diversifying sourcing away from China for cost, quality, and localisation. To partake of this, SMEs need to diversify into multiple product lines, either greenfield, leveraging current manufacturing competence, or through acquisitions to quickly build scale.

## Consumer Trends

Consumer preferences are changing rapidly across both passenger and commercial vehicles in India. This is creating demand for new subsystems and components. In passenger cars, the trend towards increased information intensity will drive demand for dashboard telematics. Similarly, heightened safety awareness necessitates intelligent braking systems, improved crash performance is making the case for tailor-welded blanks, and lighter cars will require increased substitution of metals by plastics and composites. At the same time these trends threaten to depress demand for some older technologies and related assemblies.

Addressing this rapidly shifting opportunity and guarding against product substitution risk requires access to relevant technology or process IP, which cannot easily be developed in-house, except where existing competencies can be leveraged (e.g. transfer skills in plastic moulding to composite moulding). Beyond investing in product design and prototype development, suppliers have to actively seek collaborations (e.g. for infotainment and safety component design).

## Competitive Intensity

India's auto component sector has high competitive intensity, with a large number of SME suppliers competing for similar requirements and responding to cost reduction initiatives by OEMs. Overall revenue for a sample of SME suppliers studied grew at 18 percent annually for four years to FY12; while EBITDA grew at only 16 percent annually. SMEs need to consider multiple strategic options and operational initiatives to maintain profitability.

Some of the strategic levers mentioned earlier such as aftermarket sales, product diversification, development of process knowledge, and inorganic growth, will help in gaining such an edge. In addition, excel-



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lence in manufacturing and logistics and participating in strategic sourcing of key inputs such as steel can provide gains.

## People Challenges

While there are fairly common people issues faced by the entire auto component sector, small and medium enterprises in particular have several challenges to address.

The well recognised problem of low availability of skilled technical personnel, partly stemming from a disconnect between the skills imparted by ITIs and the education sector vis-à-vis those required in this sector, requires investment in further training. SMEs have a higher challenge in retention of trainees after such investment.

The large scale incidence of temporary and contractual employment in the automotive and component sector creates high employee turnover and has recently led to deterioration in the industrial relations climate. More proactive employee engagement and management of grievances is necessary. It is however difficult for companies to invest in training and employee engagement, and to reap returns by doing so, when only a fraction of the workforce is permanent. Going forward, OEMs might re-assess their approach to contractual employment and related issues such as wage disparity. SMEs can look for these shifts and re-align their own practices where possible.

The other significant challenge for smaller enterprises is the shortage of managerial talent. Several of these organizations hinge on a small number of management personnel for both strategic thinking and operational excellence.

With thin managerial talent beyond the promoter and CEO, it becomes impossible to scale up to multiple manufacturing locations, to address demanding and sophisticated customers, or to develop additional product lines.

The solution lies in deploying a more structured approach to managing human resources, with focus on actions such as creating the right structure, assessing, preparing, and aug-

menting the leadership team, investing in workforce skilling, and nurturing a talent pipeline to create readiness to handle growth in the business.

## Capital And Infrastructure Challenges

Cost of capital is an on-going challenge for Indian industry, when it seeks to compete with manufacturers in economies with negligible lending rates. For SME auto suppliers, access to capital is even more of an issue due to the current slowdown which has impacted their cash flow and valuations. Alternatives such as private equity and consolidation are being explored by various players. The cost of doing business, as well as delivery performance, is also impacted by inadequate infrastructure (e.g. low availability of power) and high logistics costs. However, interest rates seem to be headed downwards going forward, and the recent renewal in government focus on infrastructure will lead to improvement in the situation.

## Conclusion

The long term growth prospects for the Indian auto component sector are bright, with ACMA expecting turnover to grow annually at 11 percent to 2020, fuelled by growth of the Indian automotive industry as well as exports of auto components. The current slowdown and on-going changes in the automotive industry have created challenges for all suppliers. Smaller suppliers face additional challenges due to concentration risk, lack of scale, and lack of access to talent, capital and technology. However, a combination of carefully planned actions can help to position a small or medium sized supplier to the complex and evolving Indian 4 wheeler industry, to participate in the long term success of the industry. *SR*

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