Playing it right

The trick for auto component firms is to explore strategic options and unlock the opportunities of the downturn say Atish Mukhopadhyaya and Prabhakar Tiwari

India and China's growth outlook has deteriorated over the last year. China's growth has slipped to a single digit, while India has also fared poorly (according to recent IMF forecasts, India's GDP will grow at 6.1 per cent in FY2013). Western Europe is already in recession and North America is showing anaemic improvement. Overall, the world economy may have lower growth in FY13.

Poor economic outlook has impacted the auto industry adversely. It had shown some signs of improvement in the last two quarters of FY12, but FY13 numbers are not encouraging and this trend is likely to continue in the rest of this financial year as well.

Not only economic downturn but also other factors, such as cyclical nature, under-utilisation of resources and lack of technology access, are posing challenges to the auto and auto component industries.

In this business, sales are seasonal and production varies from month to month. Key factors that influence this industry are credit markets, fuel prices, economic policies and consumer spending. Changes in these factors affect the production of automobiles. For example, car sales tend to rise in the last two quarters of a fiscal year. Most Tier-I and II auto components companies are suffering from under-utilisation of their existing capacities. One Tier II auto component company from Jalandhar says; "We have casting and forging facilities, but over the last few years, we haven't been able to use more than 50 per cent of the capacity. We are thinking of diversifying into the non-auto segment". Another Tier-I supplier from Pune says: "As OEMs do not provide correct forecasting detail, we suffer from under-utilisation of the plant most of the time". A Chennai-based auto component company has blamed the cyclical nature of the industry for under-utilisation of the plant. This pattern is pervasive.

The Indian auto component industry is highly dependent on foreign players for technology transfer. For example: Anand Group, TACO, Motherson and Amalgamation group have JV partners for technology transfer with some in-house engineering capability, while very few Indian companies have credible R&D capabilities. The key issue Indian auto component manufacturers are facing is to find the right global JV or alliance partners for technology and global customer access.

In the early 2000s, most global auto component companies had entered through the JV route as they were unsure about Indian growth, economic policies and laws. However, the scenario today has completely changed. Most global auto component companies are now entering India on their own. Moreover, they have realised that North American and Western European markets have saturated and future growth will only come from countries like India, China and other emerging economies.

Customers are becoming sophisticated and are opting for enhanced safety features, infotainment and advanced electronics in their vehicles. Moreover, technologies like hybrid and electric cars are also likely to enter India in the near future. At this juncture, Indian auto component players are not equipped on their own to cater for such needs, and foreign players, like Bosch, Borg Warner, Delphi, with their superior technology and offerings are likely to dominate the market in this segment..

Strategic options

There could be a number of strategic options to sustain and grow depending on a clear understanding of core competence and weaknesses.

- **Product and intellectual property development**: This option is difficult to pursue and may not result in profits in the short-term; but certainly in the long term it will be fruitful. Companies like

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Bosch, Delphi and others have traditionally spent significantly on R&D and have well-established proprietary products. In contrast, Indian companies lag behind international players in owning or developing their own IPs. However, Indian companies can enhance their capabilities by reverse engineering and tear-down analysis. This could cover products across competition and those available in different geographies. The intent would be to build prototypes for the next level of evolution for existing product lines, along with value engineering and value analysis (VA/VE). For example, a Jaipur-based automotive lighting company has proactively adopted reverse engineering strategy to develop multiple product lines to cater for various OEMs, including MNCs, in India. These initiatives could be helpful to counter under-utilisation and to create product pipelines for future.

- **Aftermarket entry:** The auto aftermarket was worth around Rs15,000 crore in FY12 and is expected to grow at 15 per cent CAGR over the next five years. A few Tier-I suppliers, such as Gabriel, Minda, Rane Brothers and TVS-Lucas, have recognised this opportunity and entered the market. They have set-up their own network of distributors and dealers to expand their markets.
- **Partnership with retailers:** A few firms have gone beyond aftermarket and entered into partnerships with auto accessories retailers, like Reliance AutoZone, Carplus, in order to participate in the organised auto retail market.
- **Enter the oligopolistic market:** Entry barriers are high as this type of market is dominated by a few players, such as Exide and Amaron in batteries, MRF, CEAT and Apollo in tyres). It is advisable to enter such a market if one has strong brand recognition or deep pockets to develop capabilities and scale.
- **JV partners from developing economies:** Tier-I suppliers from Western European and North American countries are entering India on their own. Therefore domestic Tier I suppliers may not find alliances or JV partners from the Western world. Partnering with infotainment, safety and car electronics companies from South Korea, Taiwan and other emerging economies could be a good option.
- **Target non-auto customers/segments:** A company with auto composite expertise can extend its capability to non-auto sectors such as building and construction and electrical; a company with exterior and interior plastic capability can extend this capability to non-auto sectors, such as mining, oil and gas, infrastructure, mining and construction equipment, consumer goods and HVAC. Bharat Forge and Mahindra composites have made use of their core competence to extend offerings to non-auto sectors. The downturn is a boon to developing prototypes and new products using spare capacity and effectively using management bandwidth to sell and develop new customers.
- **Growth of existing business:** Introducing new products in the existing business, improving operational parameters to reduce overall cost structure and upgrading business development processes are initiatives to be pursued.
- **Enter into other geographies:** The auto industry has become integrated. Indian auto component companies are also trying to be global by acquiring companies outside India. However, it is not advisable to move to other geographies unless a company meets some of these ground rules: first, the company should have a privileged position in the home country; second, it should possess product IP (e.g. Bosch, Delphi, Honeywell etc.); third, there should be high levels of operational excellence which give it a cost or quality advantage (e.g. Bharat Forge, Toyota etc.); and the fourth if it has an anchor customer (e.g. OEMs like GM, Ford, Volkswagen have brought their Tier-I suppliers from their home country to India). But Indian auto component companies should prepare themselves to cater for global needs and, if required, should be ready to move to other geographies too.

When the chips are down, the best way is to aggressively seek new improvement levers. Companies that seize the opportunity to creatively manage adversity, build the foundations of a sustainable, de-risked and growing organisation.

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