

US Auto Industry - Where do things stand?

- Ravi Gogate, Senior Marketing Manager, Industrial Systems Division, Hitachi America Ltd.

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During first six months of 2009, according to Autodata, a leading data-source on auto industry, GM, Ford and Chrysler together sold 2,191,957 light vehicles. This made up for 45.6 percent collective market share, down by 3 percent from their share during first six months of 2008. What is more alarming is that this accounted for 39 percent fewer units sold, compared to those during first six months of 2008. Total number of light vehicles sold in the USA by end of June 2009 was 4,808,838 compared to 7,412,109 a year ago. A drop of 35 percent! It is also notable that by June 1999 the big three (no more) collectively had a 70 percent market share of light vehicle market in the USA.

Who needs a smaller, lighter car?

During the first oil crisis (October '73 till March '74) when OAPC countries laid an oil embargo on the USA,

European nations and Japan, virtues in energy conservation were quickly understood. Though everyone understood benefits of fuel efficient, smaller vehicles, US automakers and policy makers did not develop any long term plan to bring about real changes that could have set grounds for an innovative and competitive US auto industry. During mid 80's oil prices plunged and US automakers were once again successful in lobbying for lower fuel economy standards. Their focus was shifted to minivans, SUVs and pick-up trucks. These vehicles only seem to grow in size and popularity over the next decade.

It is true that over last 30 years US automakers have made significant improvements in overall quality and performance of light vehicles; but this has not happened as a result of any long term developmental program undertaken by the US government and the US auto industry.

This is largely owed to improvements in industrial manufacturing, advances in electro-mechanical controls and use of lighter metal alloys and composite materials.

Analysis



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Japanese and European manufacturers, however, did set their focus on development of smaller and fuel efficient engines while paying stricter attention to component quality and assembly. Even though, they developed larger cars for the US market, they also kept up with their developments of smaller and fuel efficient models. That included the ones to use alternative fuels such as high ethanol blend, diesel, natural gas and hydrogen and the ones to use electric hybrid drive-trains (EHV).

Today, Japanese automakers have almost 40 percent US market share. European and Korean firms each have grabbed over 7 percent of the market. In June 2009, after months of uncertainty, US Department of Energy is set to lend money to automakers



from its special \$25 billion fund program. This program is designed to offer government aid to build next generation fuel efficient and battery operated cars. Ford Motor Co, Nissan Motors and Tesla Motors are the first ones to receive their share. GM and Chrysler are not yet qualified as financially viable. They will have to work their way up as they reorganize themselves coming out of their bankruptcy. In exchange for a larger loan share, Ford has already offered to convert three of its large plants that make large trucks and SUVs, into making smaller fuel efficient vehicles. Additionally this year Ford has also introduced two mid-size electric-hybrid models that are rated to offer over 30mpg performance. Even though the program was designed for US firms only, Nissan was qualified over its plans for an all-electric car with a range of 100 miles (160km) on a single charge. Today, about seventy five companies including start-ups have applied, asking for about \$38 billion in loans!

Is it all lost for GM and Chrysler?

Much remains to be seen as Chrysler and GM emerge from their “arranged” bankruptcies. Historic turn of events has forced these two firms to shed brands, to make payroll cuts and to shut down dozens of dealerships.

Last month, Chrysler was named Chrysler Group LLC, after spending about six weeks in bankruptcy. It is now managed by Sergio Marchionne, CEO of Fiat Auto SpA. Quick court ruling has helped GM to come out its bankruptcy in just thirty nine days. While its CEO Fritz Henderson gets a second chance, 60.8 percent of the new GM will be owned by US treasury. The retiree health-care trust of UAW will own 17.5 percent, Government of Canada will own 11.7 percent and the bondholders of old GM will own remaining 10 percent. Who would have ever thought that buying GM bonds will be risky?

It seems that there is only one clear solution left for Chrysler and GM, and that is to build cars that would appeal

to American consumers, plus plan to cut costs in order to compete with foreign firms. This may be harder to implement given that both firms still carry significant pension liabilities and unproductive assets. PBGC will cover pension liabilities for GM retirees but it may do so at cost of reduced benefits to younger retirees. Both firms simply will not be in position to support 100 percent pension benefits to all its retirees if they want to achieve their cost reduction goals. Chrysler may gain access to markets in Europe and Latin America where smaller Fiat cars are somewhat popular. Of course, this will happen in exchange for allowing Fiat to introduce its smaller cars through Chrysler dealerships in the USA. Potential for technology and platform sharing between Fiat and Chrysler to develop modern cars – so far seems to be a bright spot in the deal. In addition to managing money and competence, GM management will face issues of appeasement of US senators and congressmen as majority owners.

Are foreign suppliers benefiting?

As the US automakers continue to gather and reshape themselves, smaller firms such as Hyundai Motors and Kia Motors have gained notable market shares in the USA. These companies are also moderately successful in introducing luxury class sedans that are competing with top Japanese and European models. Even smaller Japanese companies such as Suzuki Motors and Isuzu Motors seem to have gained foothold in this competitive market with lower demand. Consumers are more conscious of quality and price and less of brand names given that all automakers around the world are capable of manufacturing light vehicles with reasonable quality. Larger foreign firms such as Toyota and Honda have altered their strategies of “universal platforms” to “regional platforms” that are better matched to needs and tastes of local markets. Although their gains have come at cost of US manufacturer's losses, these firms are also



demonstrating consistent quality and innovativeness in their products. Chrysler and GM have slashed their dealers by about 25 percent and 40 percent respectively. Given no other option in the short run, many of these dealers will divert to selling foreign brands. This creates a bargaining opportunity for foreign automakers to further their selling positions in the USA.

Will government rebates work?

As of July 1st, 2009, US government has initiated its CARS program (Car Allowance Rebate System). This incentive plan pays \$3,500 to consumers who are exchanging their old car rated at 18mpg for a new car that does 22 to 27mpg and \$4,500 for a new car that does at least 28mpg. For exchange of 18mpg rated light truck

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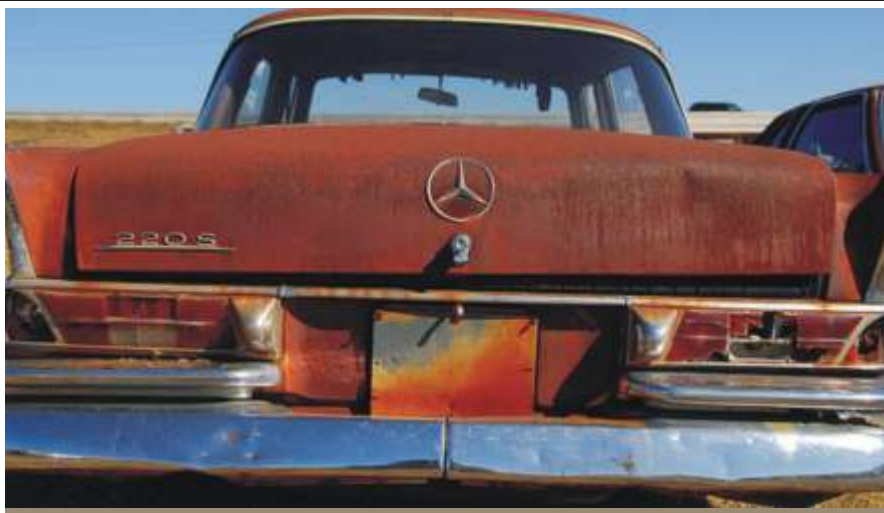
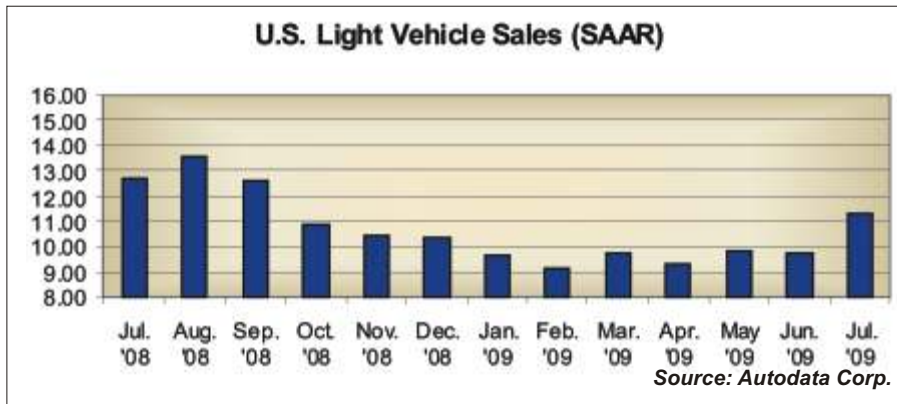
for new truck rated at 20 to 22mpg the rebate amount is \$3,500 and for a new truck rated at 23mpg and higher, the amount is \$4,500. Cost of new vehicle must be less than \$45,000 and exchange vehicle must be owned and insured by the same owner for one full year prior to the exchange date. For

this rebate to be beneficial, the current market price of the exchange vehicle has to be lower than \$4,500 by a good margin. Also in times of job uncertainty, consumers may be wary of their borrowing abilities. Some automakers (Koreans in lead) have started programs whereby one can return the new car in case of job loss or ones inability to meet the payment obligations.

While all automakers continue to improve value of their offers by means of discounts, flexible payment plans and extended warranties, the Department of Transportation has announced closure of CARS program after it ran for about 8 weeks. Given overwhelming consumer response within first two weeks, the program funding was tripled to \$3 billion from its original \$1 billion sanction. Even so, the program ran out of money by middle of August.

Toyota Motors got largest share of about 20 percent of some 500,000 vehicles sold under this program, with GM trailed close behind at about 18 percent share. As a result GM is rehiring about 1,300 workers and Hyundai Motors is bringing back about 3,000 laid off workers. Other automakers are increasing production levels at their plants. Thus the CARS program, also popularly known as “Cash for Clunkers” proved successful far beyond its projected goals, bringing total July sales of light vehicles very close to one million mark. This makes Seasonally Adjusted Annual Rate (SAAR) of close to 11¼ million vehicles. The SAAR chart below shows SAAR in millions of units over past 12 months.

Now, among seemingly good news of boost for July-August auto sales, it should be watched if such subsidies set any wrong expectations for price ceilings and if such boost is sustained over rest of the year as US economy overall seems to get “less-bad”.



Notes : OAPC – Organization of Arab Petroleum Exporting Countries
 SUV – Sports Utility Vehicle (similar to TATA Sumo)
 EHV – Electric Hybrid Vehicle
 PBGC – Pension Benefit Guarantee Corporation