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India's drive to rule the world

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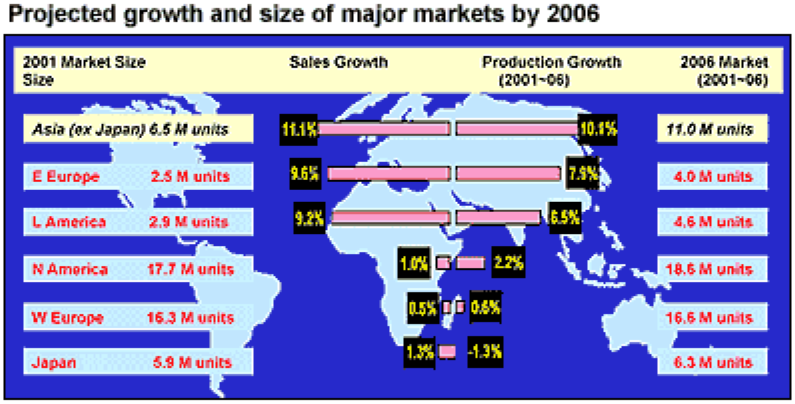
The past couple of years have marked the beginning of another growth cycle of the auto component industry in India. After a roller-coaster ride during the late 1990s and the first two years of the new century, the domestic auto component industry is settling down to a more stable and sustained growth pattern.

While raw material prices have been rising, there has been a substantial volume growth. However, while overall sales grew, the operating margins of the industry were under severe pressure. Consequently, the industry continues to lay strong emphasis on productivity improvement initiatives to sustain profitability. However, the most significant and impacting development that has taken place is in the area of global outsourcing.

Of late, a major transformation has taken place in the policies of global original equipment manufacturers and Tier-I suppliers in respect of outsourcing.

Severe cost pressures faced globally is driving these companies to increasingly look to low-cost countries like Brazil, members of the Association of Southeast Asian Nations (ASEAN), India and China. The Asia region is expected to be a major player in the auto component sector by 2006, with the total Asian automotive market, including Japan, likely to be bigger than that of Western Europe.

Projected growth and size of major markets by 2006



Source: DRI-WEFA Global Vehicle Production Report, BCG Analysis

India is expected to play a major role in this global paradigm shift. In fact, a radical change that has manifested itself over the years has been a marked change in the ambition of the auto component industry. Today, Indian industry is not satisfied with just being a sub-contractor of low value-added components for the world. More and more companies are moving up the value chain and developing technology-intensive and software-embedded component systems for the global market.

Indian auto component manufacturers have gone through a steep learning curve and are all set to make an impact on the global scenario. The industry's competitive edge stems from the availability of highly skilled manpower at relatively low cost, its ability to adapt to low-volume production using appropriate technology and automation, its capability in terms of just in time (JIT) supply using active support from logistic providers and its track record in adopting Japanese concepts and best practices like Total

Productive Maintenance/Total Quality Maintenance (TPM/TQM), Six Sigma and Toyota Production Systems/Lean to improve productivity and quality.

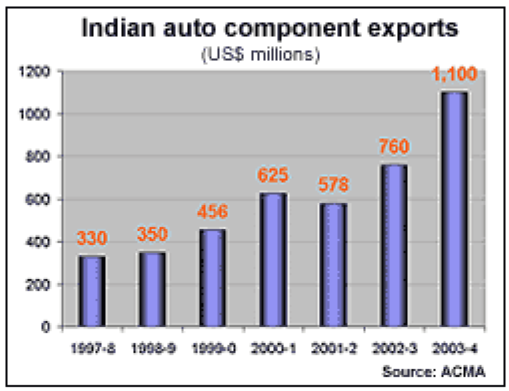
According to the Auto Component Manufacturers' Association (ACMA), there are now 384 companies with ISO 9000 certification, 223 with QS 9000 certification, 83 with TS 16949, 63 companies with ISO 14001 certification and nine companies with OHSAS 18001. Five companies have also won the Deming Prize, and one has won the Japan Quality Medal.

Boston Consulting Group holds that India's edge lies in its capability to turn out low volume, high variety of parts in which the engineering content is high - despite the fact that the size of its factories are much smaller than those in the US, China and other emerging economies.

Not surprisingly, India captured the top position in A T Kearney's 2004 Offshore Location Attractiveness Index by a comfortable margin because of its strong mix of low-cost and rich human resources. China secured second place for its low-cost and vast labor pool, though it lags behind India in terms of experience and other key factors such as information technology and management education, language skills, concern about intellectual property and overall country risk.

In auto component outsourcing, India is right on top of the heap, with 24% of the respondents (to an online survey of American automotive executives conducted by AT Kearney, India) giving it the thumbs up. Bigger auto markets like China and Mexico lagged behind at 15% and 13% while auto hubs like Brazil, Thailand and the Philippines cornered just 10%, 2% and 3% of the votes. India evidently enjoys top-of-the-mind-awareness (TOMA) in the US$9 billion North American market, despite all the anti-outsourcing noise in the US.

More importantly, the biggest share of the auto outsource pie comes from the engineering and technical services segment, which commanded 39% of the votes. And why not? In a study conducted by ACMA, labor costs account for 38.8% of sales of US-based companies, while the same for Indian companies is less than 9%. The average wage costs in India are around $6 per day, compared to up to $20 per hour in developed markets. All this, without compromising on quality. The results are beginning to show. During 2003-04, Indian auto component exports crossed the $1 billion mark to touch $1.1 billion, a growth of 38.8% over the previous year. While this landmark figure is still less than that of China or Brazil, the growth rate of Indian exports is the highest. Between 1997-98 and 2003-04, Indian auto component exports have seen a yearly growth of over 20%.



A part of this success story is attributable to the presence of global majors in India, such as:

- General Motors, USA - Global purchasing team (Halol)
- Volvo, Sweden - Global purchasing team (Bangalore)
- International Truck & Engine Co - Global purchasing
- Cummins, USA - Global purchasing team (Pune)
- Caterpillar, USA - Global purchasing staff (Delhi)
- Delphi, USA - International Purchase Office
- Motorola Automotive Electronics Division, USA
- Visteon - exporting India-made components worldwide
- Toyota Motors - Global hub for transmissions, 168,000 transmissions per year
- Daimler Chrysler sourcing components worth 70 million euro (US$86 million)
- Ford - full fledged component sourcing team
- Fiat sourcing components

Even Indian players are aiming to move up the value chain. A spate of acquisitions is a sure pointer to the sector's transition to the next phase. Right from Bharat Forge's acquisition of CDP in Germany to Amtek Auto's acquisition of GWK in the United Kingdom, and Sundaram Fasteners' acquisition of Cramlington Precision Forge Ltd, Indian auto ancillary companies are trying to enter the global market.

But despite achieving the landmark figure, Indian auto component exports of $1.1 billion are a small drop in the $1 trillion global auto component market. To increase market share, Indian companies have to overcome the following hurdles:

Economies of scale. Despite being around for 60 years, the domestic auto industry is even behind countries like South Korea, Brazil and Mexico in terms of turnover, thus depriving it the benefit of economies of scale. This makes it difficult for companies to invest extensively in research and development, a key competitive tool in the global market.

For example, as per ACMA, only 16 Indian companies feature in the $50 million to $500 million turnover bracket while as many as 237 companies have turnover ranging between $1 million to $5 million only.

Competitive threats. Countries such as China and Thailand might put a spanner in the domestic industry's wheels. While China enjoys huge economies of scale and lower labor costs than India in some areas, Thailand is believed to have excess capacity (a legacy of the East Asian crisis) and depreciated assets. These countries are thus capable of beating India at its own game, that of low costs.

Trade agreements. The growing number of FTAs (free trade agreements) that are being signed by India is likely to hurt the domestic players as they pay a relatively higher duty of around 25%, compared to 1%-10% paid by their Asian counterparts.

Fortunately, however, the entire sector is upbeat. The small and medium enterprise (SME) sector is enthusiastic on taking technology investment initiatives to become self-reliant and globally competitive, according to a Confederation of Indian Industry (CII) survey report on auto-component SMEs. The survey reveals that Indian SMEs manufacturing auto-components are well equipped to produce components as per international standards. Besides supplying to domestic automobile manufacturers, these SMEs have now started taking strategic positions in international markets - both at the original equipment manufacturers and the replacement supply horizons.

A recent study by McKinsey mentioned that India's auto parts industry has the potential to expand five-fold by 2015 to $33-40 billion, from $6.7 billion in 2003-04 by exploiting local cost advantages. According to their estimate, global auto parts sales in 2015 will be $1.6 trillion, and Indian firms could address 40% of that market valued at about $650-700 billion.

"The potential growth could create 2.5-3 million additional direct and indirect jobs and provide significant employment opportunities for people in rural areas and small towns," McKinsey noted.

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