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MARKET FORCE ANALYSIS OF INDIAN AUTO COMPONENT INDUSTRY

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Abstract

The decade of 1985-1995 was an important watershed in the history of international automobile industry. World demand for automobiles had stagnated, with declining international competitiveness, throwing North American and European automobile manufacturers into labor turmoil. While these problems festered in the West, the Asian auto market was exploding. Economic growth rates were high throughout the Asian region; a middle class with a significant disposable income was emerging; and number of people, who owned cars, increased. The Indian auto industry in the early nineties was influenced by the liberalization wave and was flooded with top brands from across the globe. As a result of the derived demand, the scope and opportunity for the component industry increased manifold. This paper traces the evolution of Indian auto component industry. Porter Five Force Analysis is performed and the market forces are analysed to assess the current status of the industry and predict the future potential.

Keywords : Five Force Analysis, Auto Component Industry

Introduction

From being a supplier of components, Indian auto industry is maturing to become a sourcing base for international auto majors for exporting Completely Built Units (CBUs). Post liberalization, Indian economy grew at an average rate of 6 to 7 % from the conservative growth rate of 3 ½ % and is expected to touch 10% by 2007. The recent robust growth of auto component industry is attributed to good growth in domestic automobile industry (CAGR of 14% in 2005: Mckinsey Report), rapidly growing replacement market, shorter product life cycle of automobiles and a global outsourcing boom.

The Indian auto component industry responded to these challenges by adding capacity and modernizing existing plants. The Indian auto component industry which was \$ 3.1 billions in 1997, with a CAGR of 9% for (1997- 2000), grew to more than \$ 10billion in 2005, with a CAGR of 20%. With a projected CAGR of 17% for (2005-2014), the Indian auto component industry is predicted to reach \$ 40bn

by 2014 (Source: ACMA). Using a combination of global expansion, domestic consolidation and quality management, the auto market has grown phenomenally. Almost all the top OEMs have made their presence in India. Hyundai and Ford have made India a manufacturing hub for particular models of cars. Other MNCs such as Toyota, GM, and Daimler Chrysler source their components from India. Global tier-one suppliers like Delphi and Visteon have set up component manufacturing units in India.

Michael Porter Model

The five forces model of Porter is a business unit strategy tool that is used to make an analysis of the attractiveness (value) of an industry structure. In analyzing the market forces at work in the Asian auto sector, Porter's "five forces model" is deployed. Porter's five forces model (Fig 1) is used to analyse the competitive environment for Indian auto component industry. The five forces are: 1) the bargaining power of suppliers, 2) the bargaining power of buyers, 3) the threat of substitutes,

4) the degree of competition, and 5) the degree of globalization in the industry. The sixth force is Government and it is also considered in this analysis.

1. Threat of Entry

Attractive as high barriers to entry

- Establishing a auto component industry requires strong financial backing as manufacturing process involves setting up of heavy machinery
- Building brand and product differentiation becomes more expensive and difficult since low price components are increasing in number, especially with the influx from China. (between '02-06, Chinese component imports have grown at a CAGR of 120% : Source ACMA)

Unattractive as low barriers to entry

- Deregulation in the Indian industry removed barriers to entry for global auto component manufacturers.

Global auto majors and domestic giants are pulling out their purses and putting their money where the production lines are.

- Auto parts maker Robert Bosch of Germany will invest US\$ 201.4 million in its Indian subsidiaries over two years. Bulk of the investment will be in Motor Industries Co Ltd (Mico) — the Bosch flagship in India.
- Crosslink International Wheels, the Indian arm of Malaysia's leading automobile security provider, Wheels Electronic SDN, is setting up a manufacturing unit at Baddi to make India an export hub for the SAARC region.
- GKN Driveline, an arm of UK-based auto component company GKN, plans to open a new manufacturing facility in India.

- Dubai-based auto ancillary major Parts International Company has plans to invest approximately US\$ 3.6 million in India over three years. This includes setting up a manufacturing facility meant to service exports to CIS and SAARC countries.

- Fiat India is taking baby steps in becoming a global sourcing hub for components. Fiat has exported components worth US\$ 8.3 million last year to its operations in South Africa.

- The market is big and poised to grow. It is currently growing at 19% p.a. and it is projected to maintain the high-growth phase of 15-20% till 2015.
- Switching costs for OEMs are low, as components are custom made to specifications.
- Established companies can enter new product category or newer markets

Conclusion : *The market is big and is growing. Entry of new players in terms of a new product line or a new market is likely.*

2. Power of Suppliers

Attractive as low bargaining power of suppliers

- The presence of very few suppliers of a particular product, and the absence of any substitutes for the product proved to be very costly. In such cases, the suppliers were in a better position to dictate terms.
- Established and bigger OEMs such as Ford and Hyundai get better deals on their orders.
- The relative absence of local suppliers, provided a long-term bargaining advantage for western firms.

Unattractive as high bargaining power of suppliers

- Local suppliers have little bargaining power vis-à-vis the major auto firms because India lacks a network of suppliers capable of bargaining with long established and technically savvy OEMs.

- A lot of suppliers depend on automakers to buy their products. But if the automaker decided to change suppliers, it would badly affect the suppliers' role in auto manufacturing.
- In fact, the relative absence of local suppliers provided a barrier to entry into these markets. Because local content requirements were mandated throughout Asia, firms wishing to locate production facilities in the region had to provide years of technical training, certification processes and technology transfer. As individual firms provided firm-specific training, certification, and technology to local suppliers, their dependence on those firms was assured.
- Manufacturing practices will have to change considerably to come closer to lean production.

Conclusion: *Suppliers have relatively low power, but if many new players enter the market, costs will come down. However if companies compete through specialisation by product-type, and integrate operations across the related area of specialization, they will be able to ascend the value chain.*

3. Power of Buyers

Attractive as low bargaining power of buyers

- High demand gave local buyers in Asian markets little say over the level of product differentiation required and therefore OEMs were in a good position to slow product cycles and reduce manufacturing costs.
- Buyers must mobilize against monopoly players or risk becoming price-takers.

Unattractive as high bargaining power of buyers

- OEMs have more choice and more access to information
- New competition in the various product segment increases buyer power

Conclusion : *The total components market is the sum of OE consumption market and aftermarket sales. The drivers for these two markets are relatively distinct. A growth in the economic activity, increase in the personal disposable income, growth in rural economy, multiple finance options, decline in tax rates are the factors which drive the OE market. But the growth in old vehicle population and an increase in the customer awareness level in using branded-genuine parts are the main drivers of the aftermarket sales.*

4. Threat of Substitutes

Attractive as low threat of substitutes

- As in other parts of Asia, auto manufacturers in India do not face a "threat of substitutes." Public transportation is underdeveloped, even in the cities. Four factors are responsible for reducing the threat of public transport as a substitute for automobiles.
- Public transport is not efficient in serving areas with low population or employment densities. Low usage means infrequent service and infrequent service, in turn, deters users. The kind of demographic fragmentation that characterizes most of India is an almost insurmountable challenge for public-transport systems.
- Rapid growth of Indian economy has changed travel patterns as new growth areas have sprung up. Fixed transport systems, such as rail lines, quickly become obsolete under conditions of rapid growth. The sunk costs that characterize mass transit systems are simply too high in areas where the shift from rural to urban demographics is rapid, and also too high when growth in developing economies is low.
- Public transports have high opportunity costs. Flashy rail systems can consume resources that could serve far more people if devoted to improving bus travel.

- Preference for public transit decreases as income level rises; at the same time, consumers increasingly prefer autos to motorbikes.

Unattractive as high threat of substitutes

- The cost of automobiles along with their operating costs and the rising price of gasoline is driving customers to look for alternative transportation options.

5. Competitive Rivalry

Attractive as low intensity of rivalry

Auto component manufacturers try to counter increasing rivalry by forming strategic alliances

- Potential trends among some competitors are to add some “frills” and flexibility. Automakers are tempted to offer value added services to the customers incurring more costs.
- Easy finance options and long term warranties are available to lure the customers.

Unattractive as high intensity of rivalry

- Due to deregulation, there is increasing rivalry and more competition for more product lines.
- Cost is critical to compete with established players.
- Capacity utilization is especially critical when margins are low.
- Increasing number of rivals are entering the sector, thus most of the auto component manufacturers will find themselves competing head – to- head in the same product sector.

Conclusion: *Competitive rivalry has the potential to be intense. Automakers that enter the Indian market can count on a low volume of sales at the outset, with the expectation that demand will eventually increase. They therefore must be willing to produce a number of product types to find a wider initial market.*

6. Government Policy

The Government policy according to many authors (Brandenburger & Nalebuff (1995) ; Kevin P. Coyne & Somu Subramaniam (1999)) should be treated as the sixth force, although Porter says that the effect of government on an industry is felt through one or more of the five forces.

Attractive as good policy maker

- The Government of India has allowed automatic approval for foreign equity investment up to 100 percent for the manufacture of auto components.
- Manufacturing and imports in this sector are free from licensing and approvals.
- There is no local content regulation in the auto industry.
- India as a democratic nation has an edge over other non-democratic countries like China in terms of boosting investors’ confidence.

Unattractive as poor policy maker

- Present structure of multiple and cascading taxation is an obstacle for procurement and discourages the tiering of the supply chain. (Over 20-30% of all parts are uneconomically sourced due to central sales tax distortions, which have no MODVAT relief (A.T.Kearney survey).
- The growing number of FTAs (Free Trade Agreements) being signed by India with Asian countries is likely to hurt the domestic players as they pay a relatively higher excise duty of around 25% as compared to 1%-10% being paid by their Asian counterparts.

Conclusion

The Indian auto component manufacturers have made a sustained shift in the value chain. In the 1990s, the Indian auto components market was dominated by supplies to the aftermarket, with only 35 per cent of exports

being sourced by Tier 1 OEMs. Today, it is a very different story. Indian automobile component manufacturers supply 75 per cent of their exports to Tier 1 OEMs (Original Equipment Manufacturers) and only 25 per cent to the aftermarket.

Exciting times lie ahead for the Indian automotive component industry. Besides the burgeoning demand from global auto majors, there is also the domestic car industry, which is growing at a spanking rate of over 16 per cent, driven by a rising consumer base and affordable loans. There are three areas in which locally owned firms might prosper within the global auto components industry:

- (a) As second-tier component manufacturers operating within value chains supplying assemblers in the domestic market;
- (b) Allied with transnational companies and supplying specialized products for global markets;
- (c) As suppliers to both domestic and international after markets. The ability of locally owned firms to compete in each of these markets can be influenced by support provided by local and national institutions.

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Figure 1 : Porter’s Five Forces of Competition framework

