



# Development of the automotive supplier industry in Eastern Europe

Roland Berger study – Summary

Vienna, April 2007

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**A. Study objectives and methodology**

Over 380 suppliers in the EE region are benchmarked

## The basis for the study are ten countries in CEE and SEE

Study focus: Eastern Europe (EE)



- |  |   |            |
|--|---|------------|
| <ul style="list-style-type: none"> <li>• (Austria – AT)<sup>1)</sup></li> <li>• Czech Republic – CZ</li> <li>• Hungary – HU</li> </ul> | <ul style="list-style-type: none"> <li>• Poland – PL</li> <li>• Slovakia – SK</li> <li>• Slovenia – SI</li> </ul> | <b>CEE</b> |
|--|---|------------|

- |  |            |
|--|------------|
| <ul style="list-style-type: none"> <li>• Croatia –HR</li> <li>• Macedonia – MK</li> <li>• Romania – RO</li> <li>• Serbia – RS</li> </ul> | <b>SEE</b> |
|--|------------|

- Comments**
- Also comparison of macro-trends and OEM developments in CIS (Russia, Ukraine) and Turkey
  - Analysis of study based on median

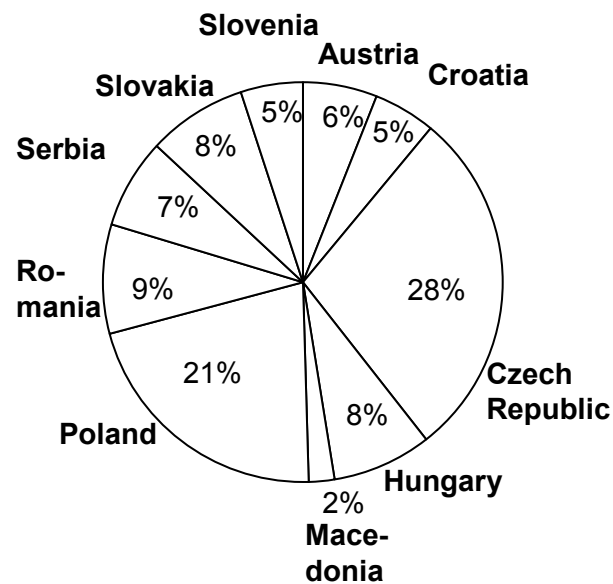
1) As comparison; macro-economically strongly integrated with CEE

# In total, more than 380 automotive suppliers have been analyzed in the EE region

Overview sample

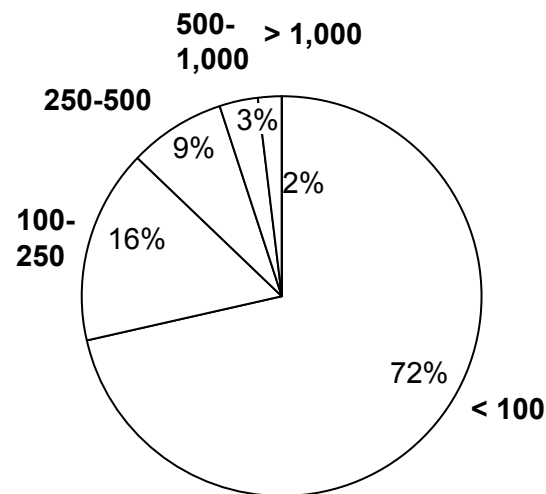
Split by country

$\Sigma = 383$



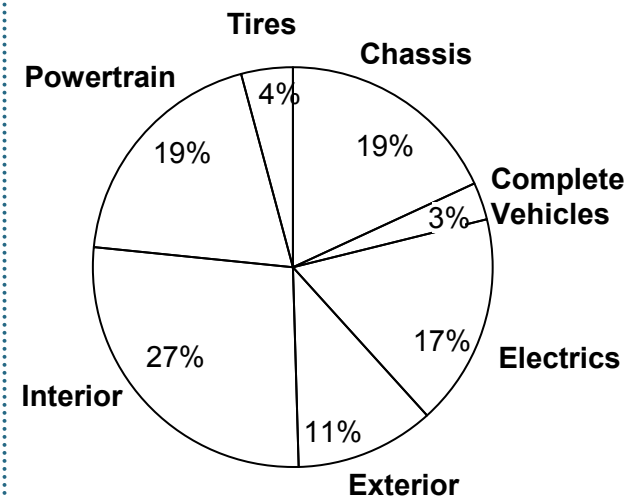
Split by sales volume [EUR m]

$\Sigma = 383$



Split by product segments<sup>1)</sup>

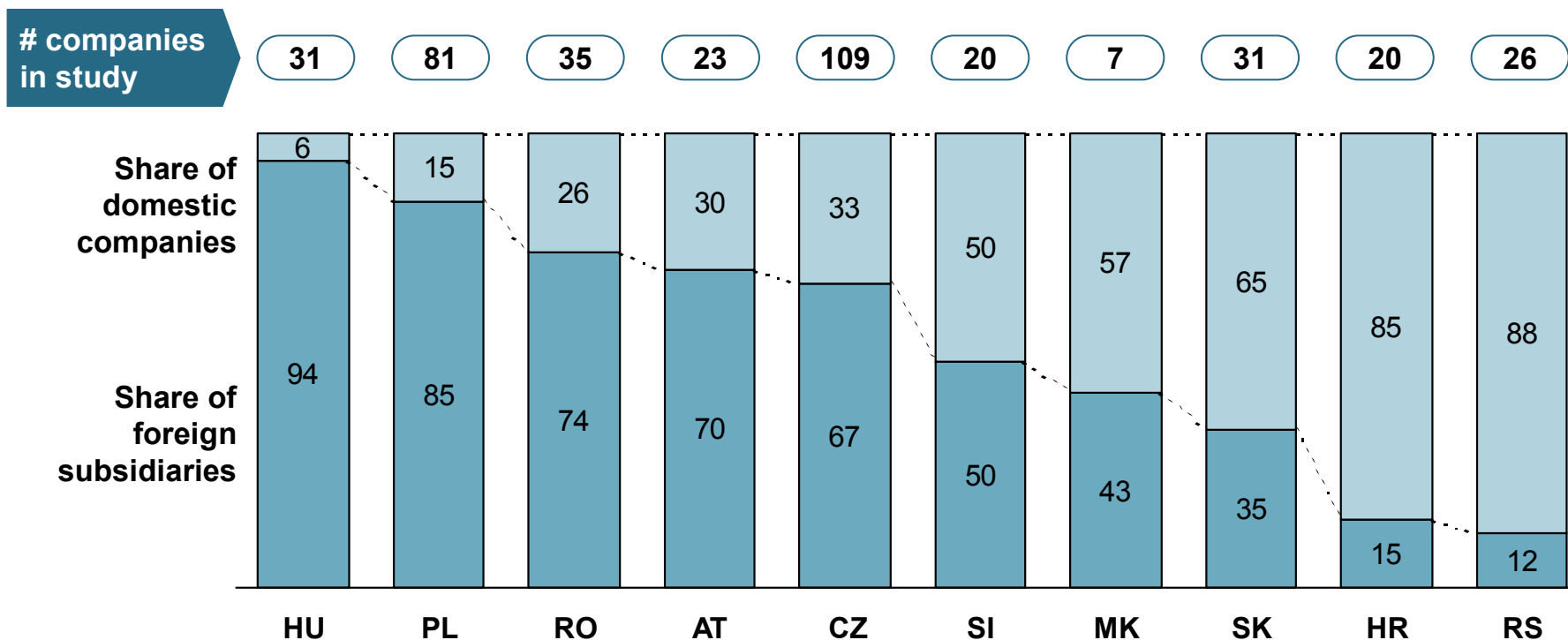
$\Sigma = 383$



1) Primary product segment defined as product with highest revenues

## In mature markets the automotive industry is dominated by foreign subsidiaries

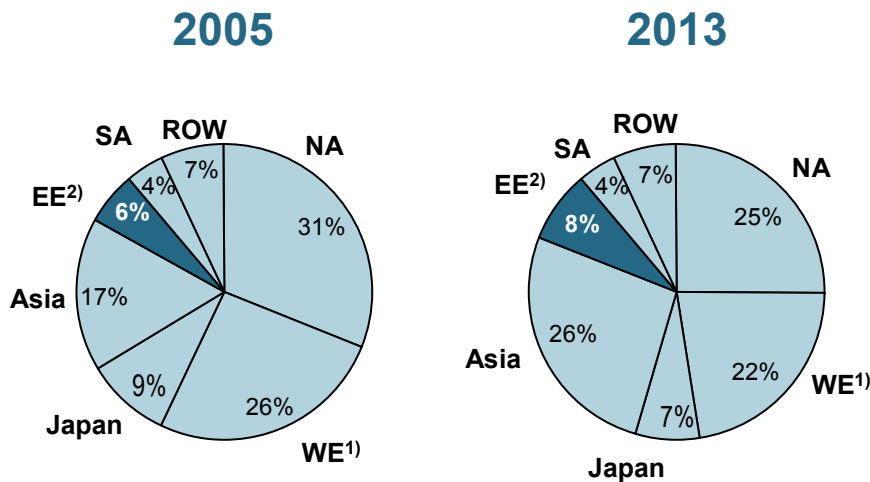
Share of foreign subsidiaries per country [% in sample]



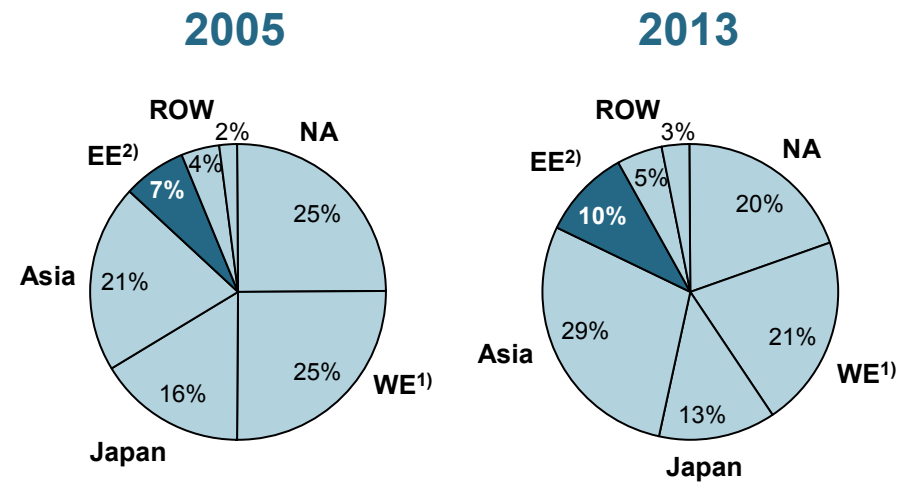
**B. The EE supplier industry in a global context**  
Major growth region benefiting from global trends

# Growing relevance of Eastern Europe in global automotive industry – But no match with growth in Asia

Global vehicle sales [%]



Global vehicle production [%]



- **Economic growth** drives vehicle demand in emerging markets
- But **Asia by far outperforms** all others, also EE

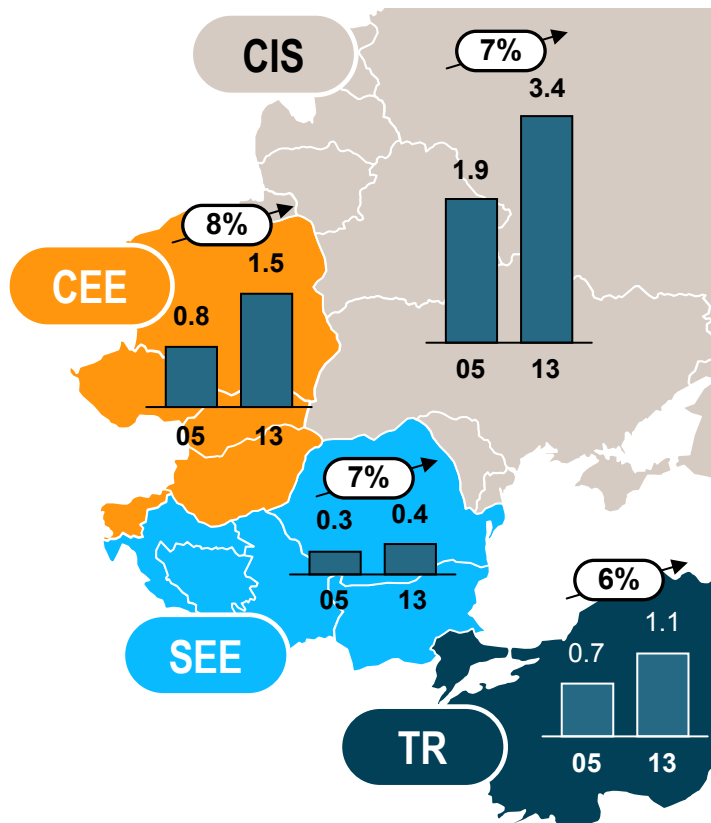
- Production has **already strongly shifted** towards emerging markets – significantly **before demand**
- **Future build-up** also mostly in these regions

1) Western Europe

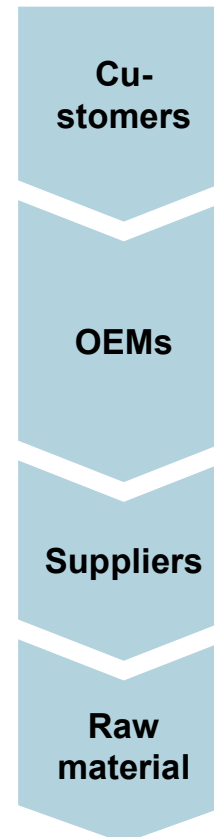
2) Eastern Europe

# Significant long term growth and industry trends favor investment in Eastern Europe

## Vehicle sales [m units]



## Industry trends in Eastern Europe



- Growing **local demand** (esp. Poland, Czech Rep., Bulgaria and Russia – more than 8%)
- Expectations towards quality and safety

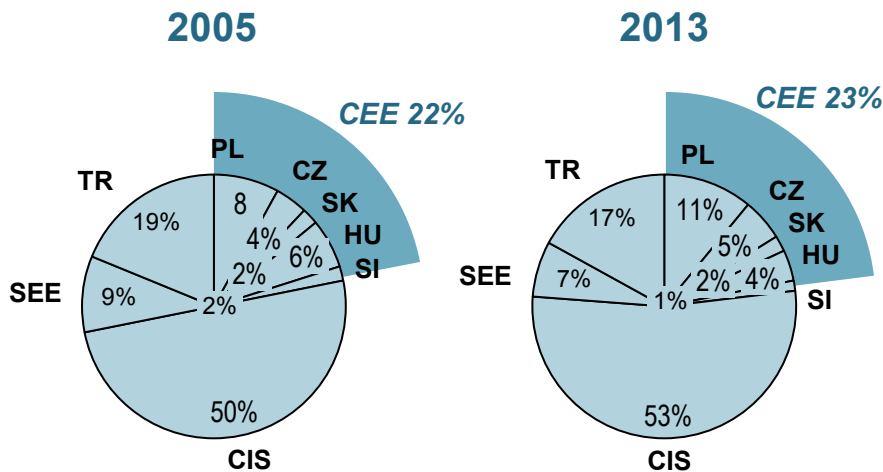
- Regional share of Asian OEMs grows to 24%
- Production increases of **9% p.a. in Eastern Europe**
- Additional capacities of 6% p.a. in CEE compared to 5% in the EE

- Pressure due to local content
- **Shift from CEE to Russia and Turkey**
- Asian suppliers develop local footprint

- Growing impact of Russia on entire region
- Competition of resources with China

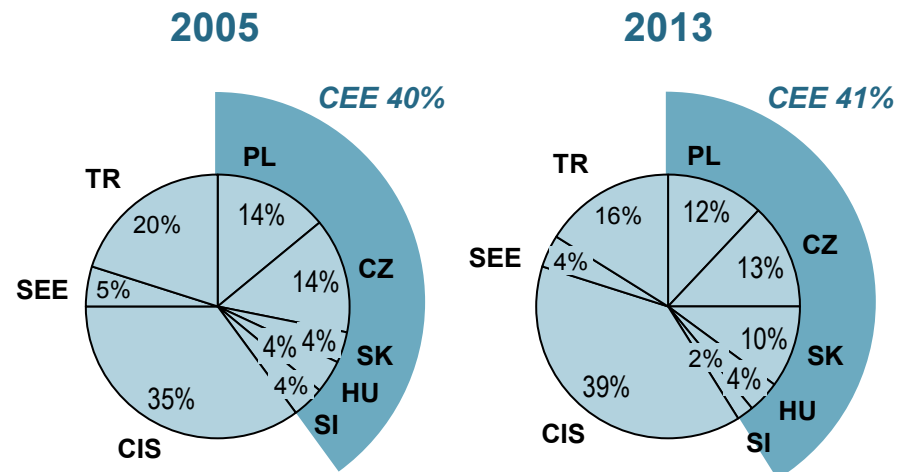
# Dominance of EU countries in production relative to sales in Eastern Europe

**Vehicle sales in Eastern Europe [%]**



- Half of vehicle sales accounted for by CIS region
- Relevance of Russia and Poland increases until 2013 due to increasing purchasing power

**Vehicle production in Eastern Europe [%]**



- EU region will also be the biggest vehicle supplier for the region in 2013 followed by CIS region
- Strong industry build up in Slovakia and Russia

**C. Detailed industry analysis for EE**

High growth and economic relevance but moderate domestic performance

## Development of supplier industry has important knock-on effects for countries in EE

Importance of supplier industry for countries

### Direct economic effects

- Increase in employment
- Growth of GDP
- Receipts of foreign direct investment
- Participation in value creation through tax receipts
- Favorable trade balance

### Know how effects

- Transfer of industry specific know how
- Installation of management best practice through foreign companies
- Positive learning effects for other high value industries

### Indirect network effects

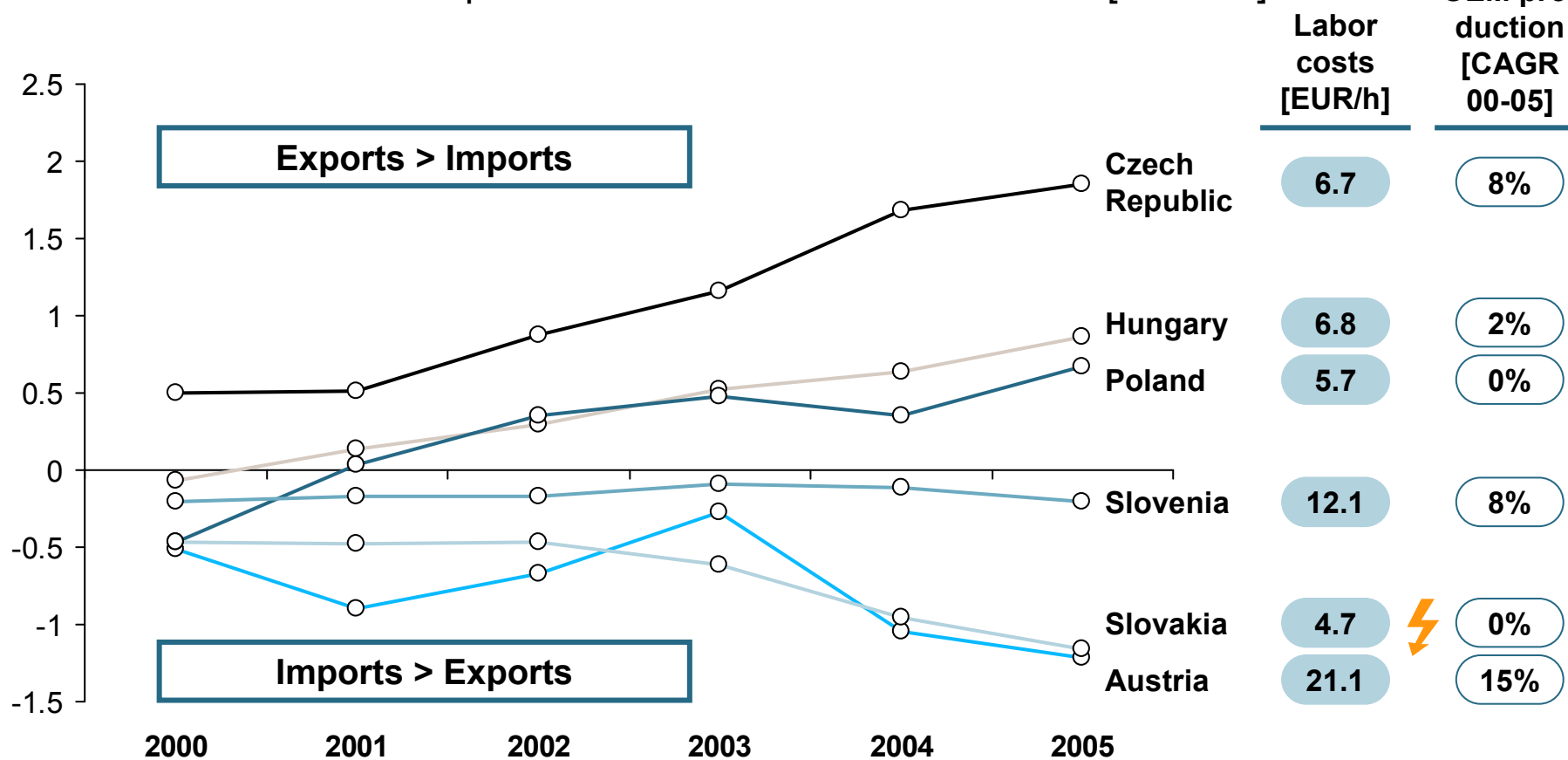
- Positive developments of related industries (e.g. materials, logistics, construction)
- Active shaping and participation of future supply industry in developing countries further east

### Structural effects

- Enhancement of infrastructure and facilities
- Image effects
- Rethinking of country value proposition to attract investments
- Possibilities for privatization

## The main drivers for the build up of the supplier industry are low labor costs and increasing OEM production

Trade balance of vehicle parts and accessories of 2000-2005 [EUR bn]



## High sales growth across the region but international subsidiaries outperforming domestic suppliers

Differences in automotive supplier growth [sales growth %]

### Regional differentiation

- Regarding sales growth **suppliers in EE outperformed all the other global regions** in 2000 and 2005
- In line with global trends, **sales growth declined by 0.4 pts. in EE in the same period** – exceptions are suppliers from North America and Japan (low basis)

### Country differentiation

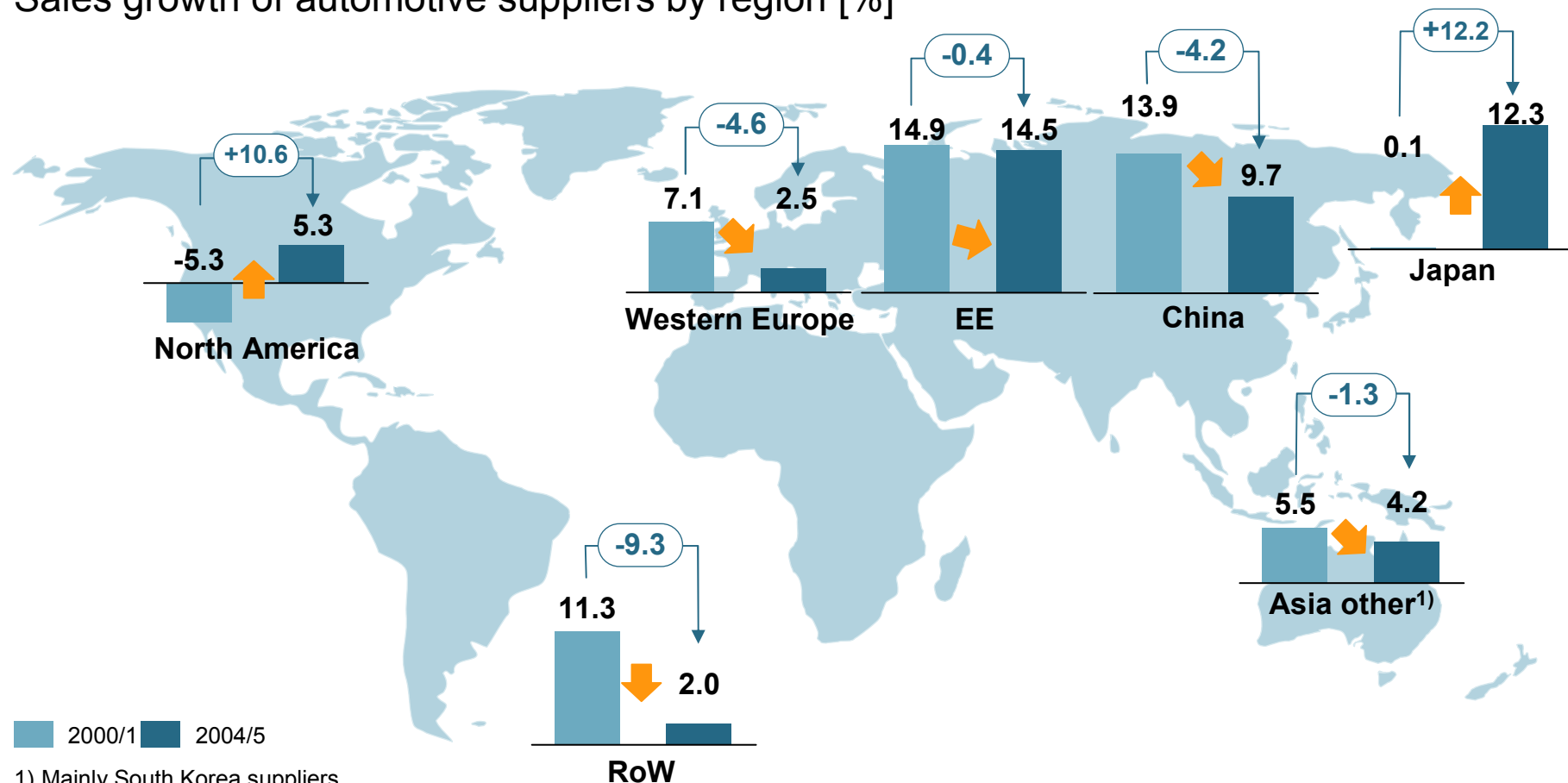
- Within EE **suppliers from Romania (66.2%) and Poland (17.2%)** achieved the **highest growth rates** in 2005 – in line with average sales growth rate over the five year period (32.1%, 17.4%)
- Contrary, Macedonian (3.7%) and Austrian (5.8%) suppliers grew at the lowest rate in 2005

### Ownership differentiation

- In course of the last five years **subsidiary companies attained higher growth** than domestic companies
- Subsidiaries outperformed domestic companies **by 50% in 2005**

## According to sales EE automotive suppliers outperformed their competitors from all other global regions

Sales growth of automotive suppliers by region [%]



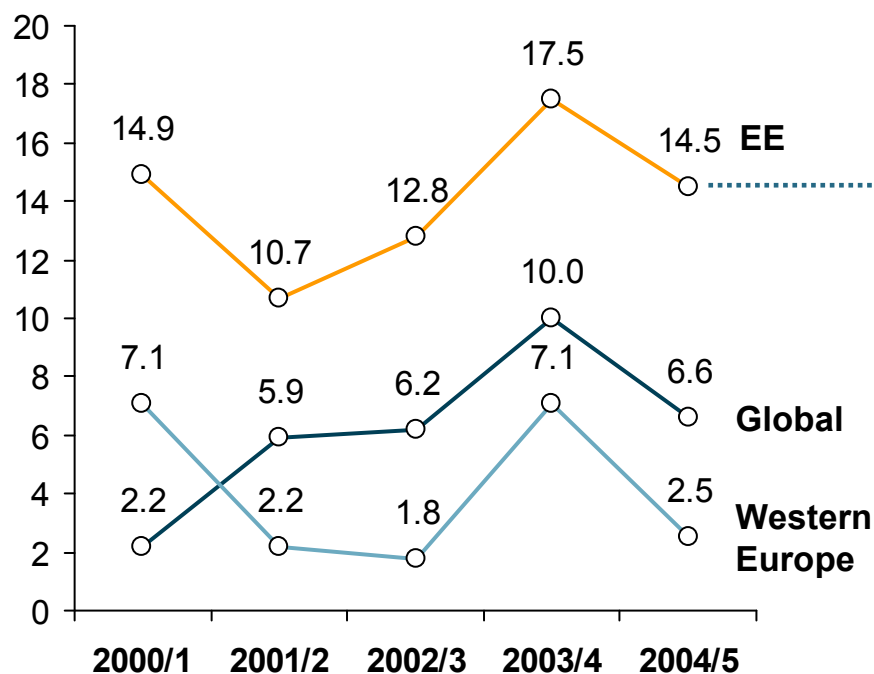
2000/1 2004/5

1) Mainly South Korea suppliers  
Basis: Median

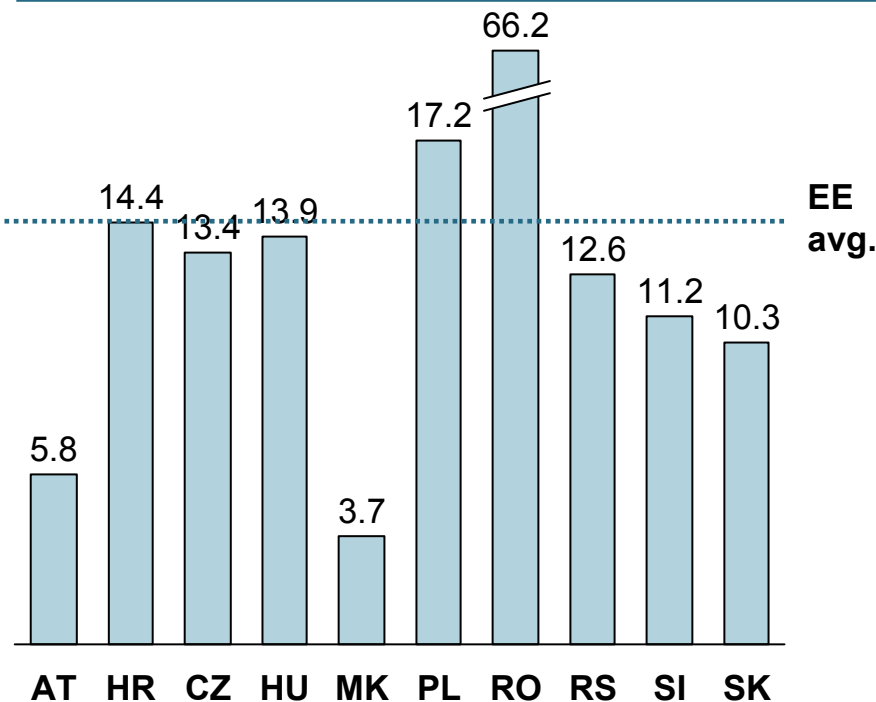
## Within the EE region Romanian and Polish suppliers are growing fastest in 2005

Sales growth of automotive supplier, per country/region

**Sales growth year on year per region [%]**



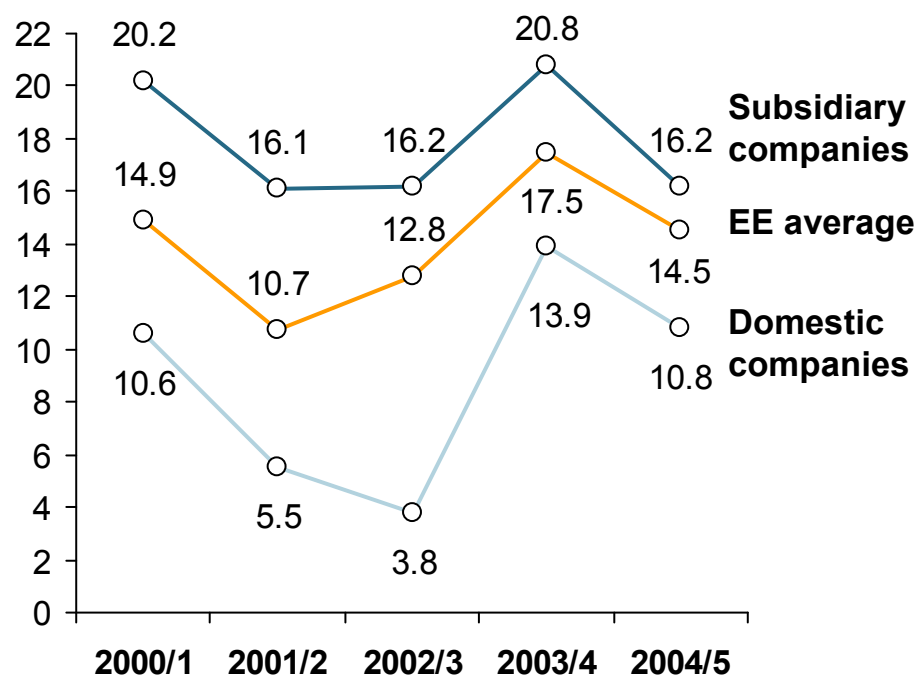
**Sales growth per country 2004/05 [%]**



## Subsidiary companies constantly achieved higher sales growth than domestic companies

Sales growth of automotive suppliers 2000-2005 by ownership

**Sales growth year on year by ownership [%]**



### Comments

- Over five year period foreign subsidiary companies constantly outperformed domestic companies with regard to sales growth
- In terms of employment and GDP impact foreign investors equally important
- However, lower growth of domestic companies is problematic
  - No build up of local know-how/ innovation base
  - Foreign ownership also means passive reaction to investment decisions
  - Profit is withdrawn to foreign HQs
- Build-up of domestic supply base represents one of the main mid-term challenges of the region

## There are significant structural differences in supplier profitability depending on country, size, product focus, and ownership

Differences in automotive supplier profitability [EBIT margin %]

### Company size differentiation

- **Large suppliers** (EUR 500-1,000 m) show the highest profitability with an EBIT margin of 5.4% but profitability does not generally increase with size
- **Most significant improvements** of 0.5% pts. of EBIT margin since 2000 achieved by **small suppliers** (< EUR 100 m)

### Product focus differentiation

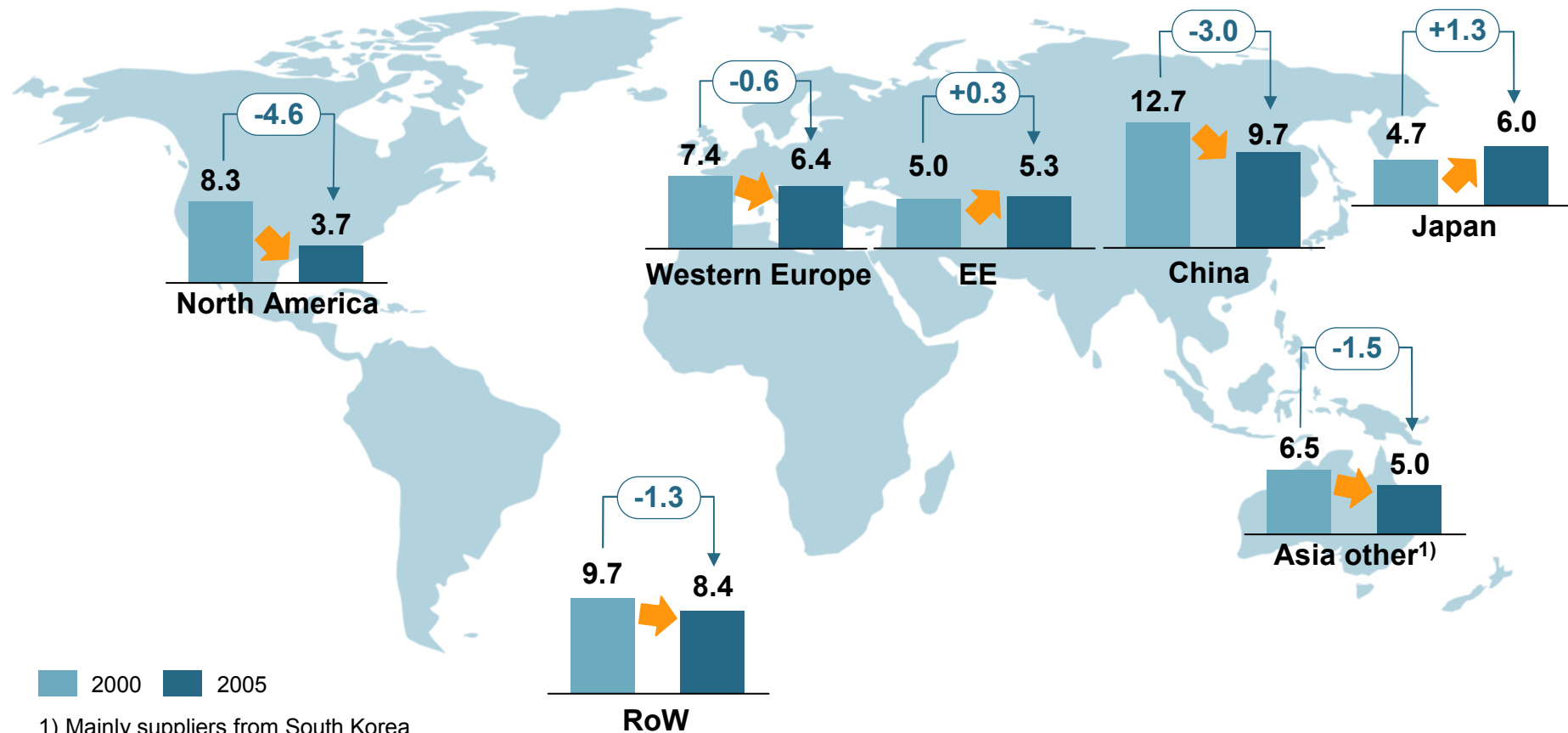
- Suppliers with a focus on **chassis and exterior** have made the strongest profitability improvements from 2000-2005 (+2.7% pts., +1.2% pts.)
- **Most profitable product segments** is by far **chassis** (7.9% EBIT margin)
- **Least profitable** suppliers focus on **Complete vehicles** (3.1%) and **Electrics** (3.7%) and have further lost profitability (-2.5% pts., -0.4% pts.)

### Ownership differentiation

- In course of the last five years **subsidiary companies attained higher profitability** than domestic companies
- Subsidiaries outperformed domestic companies **by more than 55% in 2005**

## Against the global trend, profitability of EE-suppliers increased over the last five years but is still at a low level

Profitability of automotive suppliers by region [EBIT margin %]



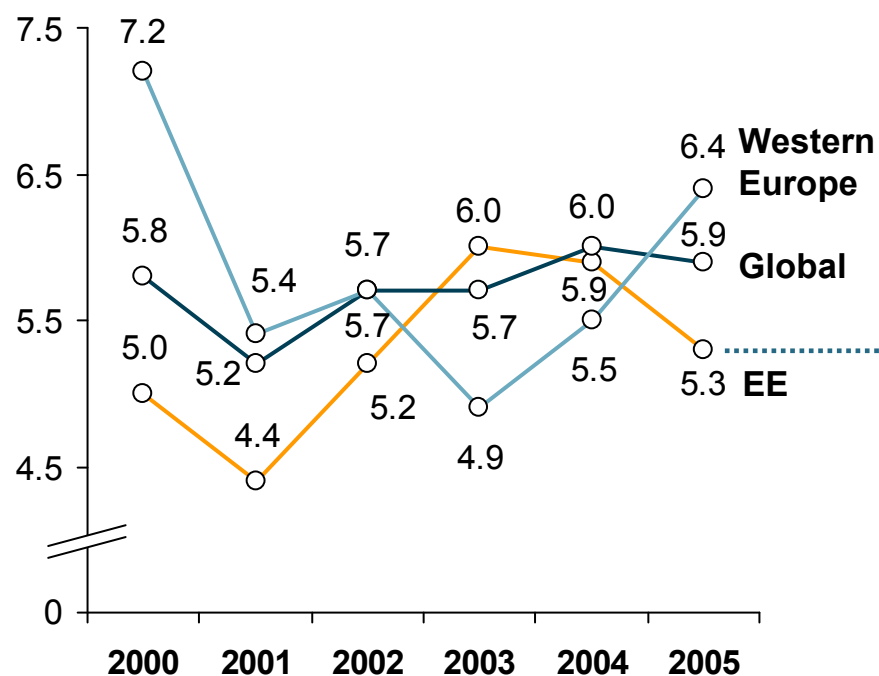
2000 2005

1) Mainly suppliers from South Korea  
Basis: Median

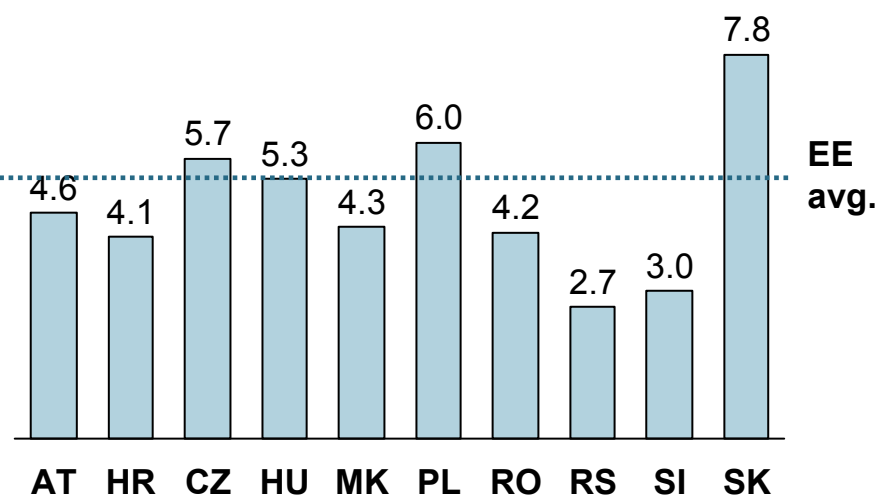
## Suppliers from Slovakia are the most profitable of the region, followed by suppliers from Poland

Profitability of automotive supplier, per country [EBIT margin %]

**EBIT margin year on year per region [%]**



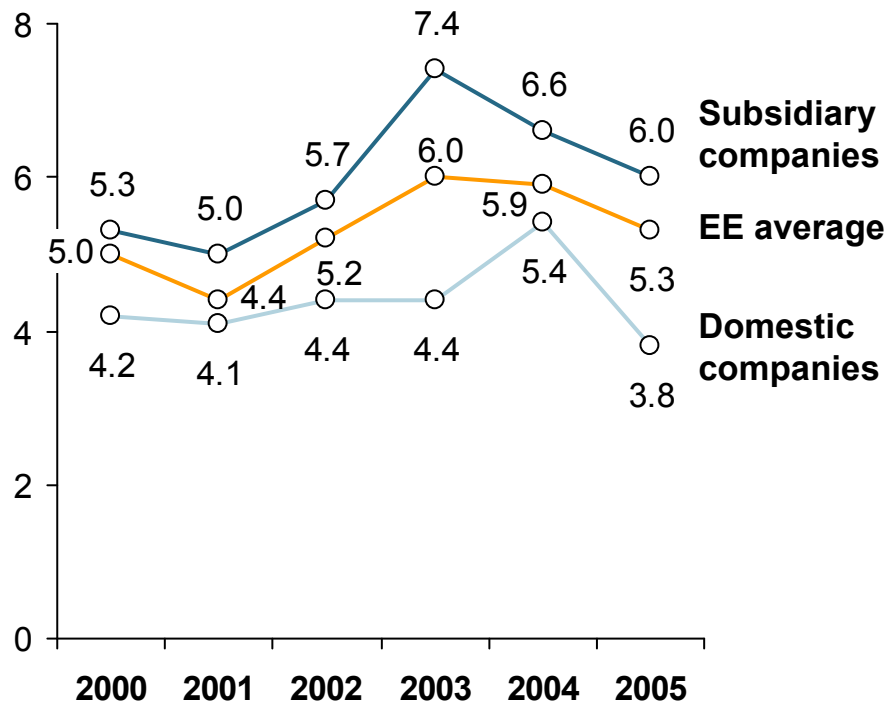
**EBIT margin 2005 per country [%]**



## Similar to sales growth, foreign subsidiaries continuously outperform domestic suppliers

Profitability of automotive suppliers 2000-2005 by ownership

**Profitability by ownership [EBIT margin %]**



### Comments

- Foreign subsidiary companies constantly outperformed domestic companies in profitability from 2000-2005
- Spread of profitability between the two types of companies was relatively small in 2001 but has been widening significantly in 2003 and 2005
- As with the difference in growth, the profit gap is highly problematic and shows a need to act for the local supply base
- (Note: profitability of foreign subsidiaries may be skewed due to transfer price tactics, partly based on lower taxes of CEE region)

**D. Summary and conclusions**  
Need to act to strengthen the  
domestic supply base

## Although EE is overall a very attractive region profitability and growth differs significantly

### Summary of main findings

- **Large suppliers** (EUR 500-1,000 m) are the **most profitable** in the EE region with an EBIT margin of 5.4%, however contrary to the global trend, profitability does not increase with size
- Suppliers in the **chassis segment** are by far **most profitable** with EBIT margins of 7.9% with **chassis and exterior** showing the most **favorable margin-developments** from 2000-2005 (+2.7 pts., +1.2 pts. EBIT margin)
- In the analyzed five years period **foreign subsidiaries outperformed domestic companies** by up to 55% in **profitability** and 50% in sales **growth**
- The **highest yearly average growth rate** from 2000-2005 was accounted for by **Romanian** (32.1%) and **Polish** (17.4%) suppliers, with sales growth of 66.2% and 17.2% in 2004/05
- **Largest share of top performers** in 2005 with above average profitability and growth was found in **Romania and Poland**
- With regard to **top performers by product segment**, only suppliers group focusing on **tires** were found in that quadrant

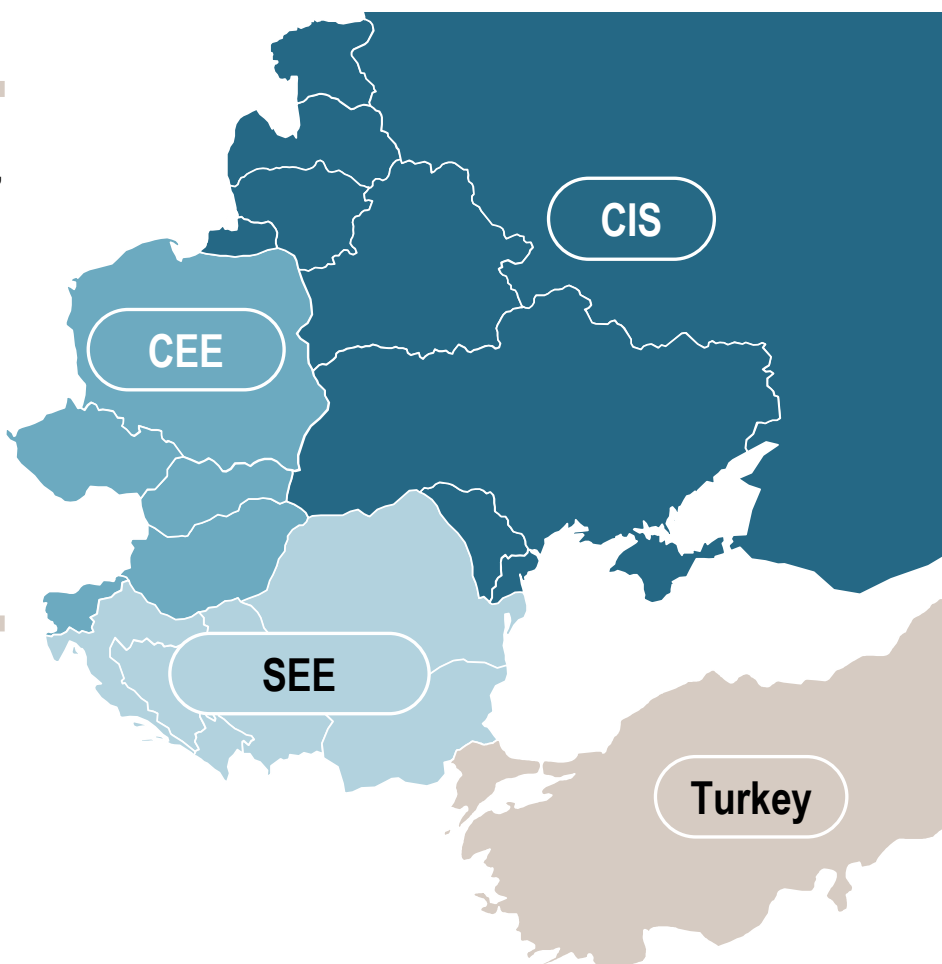
## Different regional strategies required to manage long-term structural challenges in Eastern Europe

### CEE

- Manage capacity build-up until 09/10 (esp. SK, CZ)
- Prepare for reduced growth after 2010 (develop other industries)
- Increase productivity to compensate reduced cost advantages

### SE-Europe

- Attract supply base as 2nd wave of low cost investments
- Ensure high quality labor force
- Compete with Russia!



### CIS

- Manage industry build-up (long term), esp. a strong local supply base
- Ensure local content, quality, logistics

### Turkey

- Develop supply-base, esp. domestic players
- Strengthen role as bridge to Middle-East (esp. logistics, regulations)

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