

THE UNITED KINGDOM AUTOMOTIVE INDUSTRIES

STATUS, ECONOMIC RECOVERY AND EXPECTATIONS

A report for the SMMT

EXECUTIVE SUMMARY

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The University of Buckingham
Phone: 01235 539115
E-mail: peter.cooke@buckingham.ac.uk
www.buckingham.ac.uk/cam



Foreword

The automotive sector in the UK is a vibrant and innovative enterprise. It enriches all aspects of our lives, generating diverse streams of wealth and jobs. As such it is crucial to our economy, transporting the goods we consume and getting us across town or country and even the globe. It is significant and strategic.

The UK motor industry still retains a uniquely British heritage and has successfully re-invented itself as the manufacturing home to global automotive companies. Foreign direct investment has been positive for the UK, with quality and keenness in management focusing our sectors' pool of skilled resources. It helped us retain a significant share of the global automotive market, despite fierce competition and a fast moving business landscape.

The true scope and scale of the UK industry and the economic and social value it creates has until recently been poorly understood. The skills, creativity and innovation associated with the industry have created benefits throughout the value chain from design and development, through to retail, service and repair.

In a very prosperous decade for the UK economy the automotive industry has been constantly changing, responding and adapting to challenging commercial, regulatory and technological trends. It has remained responsive, flexible and resilient. I believe this can continue and the recent report by the New Automotive Innovation and Growth Team sets out a strategic vision we all can embrace.

To help raise awareness for those with an interest in our sector, the challenges of today and ahead, industry colleagues have developed an informed and balanced report on the standing and direction of this multi-faceted sector. Industry associations and trade bodies, particularly the SMMT, RMIF and IMI, contributed their views and perspectives to create a balanced industry overview.

The panorama was broad and the timing was acute. Since initial discussions took place in mid 2008, the project has been overtaken by events, again and again. Such has been the rate of change that the report is, in reality, a third complete rewrite of the report. It should be seen as a 'Spring Snapshot 2009'.

The events and trends affecting the UK motor industry remain in a state of flux – and it is reliant on support from government in the UK and the EC to safeguard important industrial capability.

The views expressed in the report are informed, lively and independent. The report has been written by the automotive team at The University of Buckingham Business School led by Professor Peter Cooke, the KPMG Professor, with the support from the KPMG automotive group.

Paul Everitt
Chief Executive
SMMT

Executive Summary

This independent report seeks to examine the United Kingdom automotive industry systematically. It has been written at a time of unprecedented change in the global automotive industry. History may well record more changes over the next couple of years than at any time in the entire first century of the industry, in terms of strategic product development, location, ownership, manufacturing and markets.

Global migration cannot be stopped

These changes are more than merely 'rapid industry development' – they represent a fundamental move in the balance of power away from the mature industries of North America and Europe to fast-growing new economies and markets particularly in Asia. While global migration cannot be stopped – two new market opportunities each of a billion consumers are impossible to resist. That migration can be managed, however, and a new, lean British automotive industry developed. Given government support, the industry will be able to embark confidently on the necessary changes.

Importance of the UK automotive industry

The automotive industry in the United Kingdom is still one of its largest. It employs 175,000 people in vehicle manufacturing and a further 675,000 in related automotive activities. Automotive manufacturing generates revenue of nearly £50 billion and tax revenues of £45 billion. In terms of international trade, the automotive industry, including engines, generates £25 billion sales – some 10% of UK exports while imports represent £37.5 billion. Spin-offs from the mainstream industry are as important as the in-your-face numbers represent. The automotive industry's practices, technologies, research and development, skills creation and associated international business and finance are all crucial elements.

Historical context

The United Kingdom had the world's second biggest automotive manufacturing base

In the 1950s, the United Kingdom had the world's second biggest automotive manufacturing base and was the world's top car exporting nation. That position has been let slip with the UK now twelfth in the car manufacturing league. Given the emerging 'automotive revolution', it will need to take positive steps to arrest this decline and secure its position in an increasingly global industry.

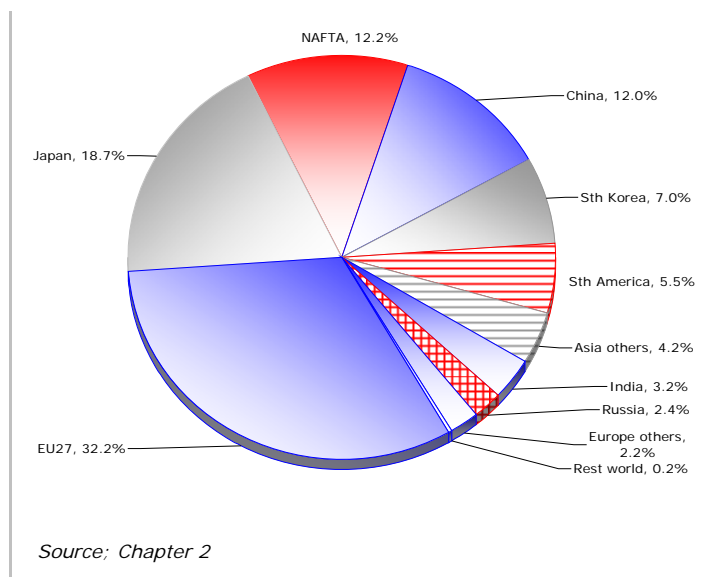
Manufacturing volumes

While manufacturing volumes have held up reasonably well, other countries have passed the UK as new facilities have been built at locations closer to the growing markets of Central and Eastern Europe, Russia, China, India and South America. The challenge is to respond proactively and beneficially to these dynamics.

The very global nature of the product, as with high-technology goods, means that global companies will seek to concentrate manufacturing in large economic units and distribute to markets – taking the logistics hit as an offset.

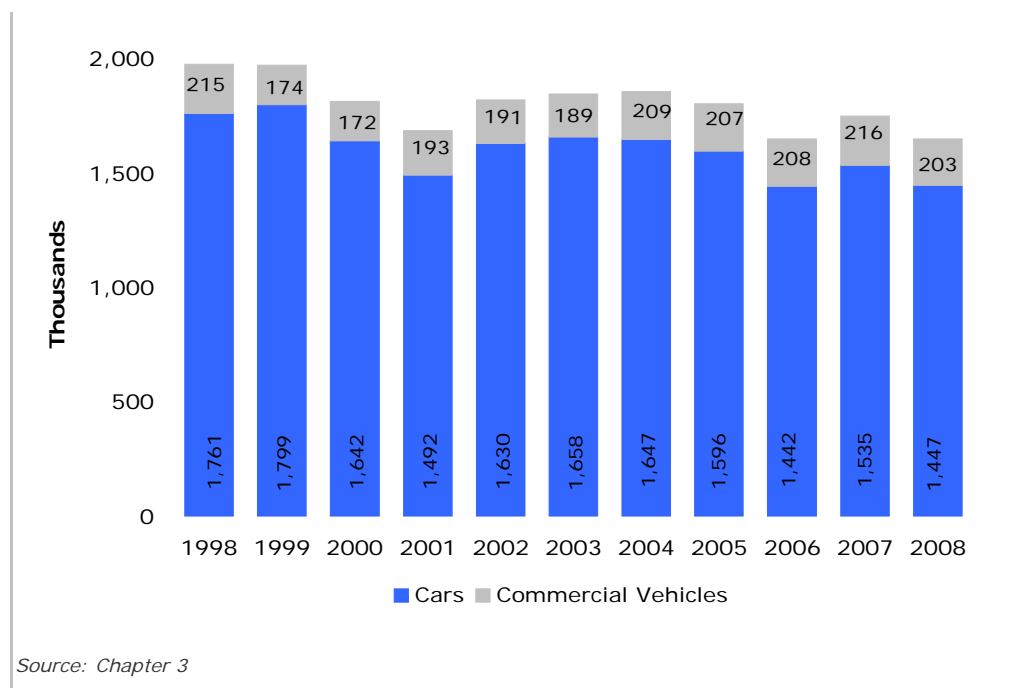
UK buyers have always had an outward-facing attitude to buying, and have been happy to buy quality car imports, particularly as there has been no major indigenous OEM for nearly two decades around which they might rally. Thus, today as much as 80% of cars sold in the UK are imported – although this is, in part, countered by a significant export market.

Figure 2.4; Passenger car production (% share) 2007



Despite the lack of a global indigenous car manufacturer, the UK has held up well. Although car manufacturing has been largely in the hands of three global Japanese and two American players, the UK has more diverse ownership of its vehicle assembly than any other automotive manufacturing nation.

Figure 3.3; UK car and commercial production; volumes 1999-2008



While productivity in some European countries may have risen more rapidly than the UK, there are still considerable benefits to be had in terms of labour quality and flexibility, a sophisticated and mature supply chain, logistics, a relatively stable political and economic regime – and the third biggest new car market in Europe.

Could there be a basis for a rejuvenated, refocused automotive industry in the United Kingdom?

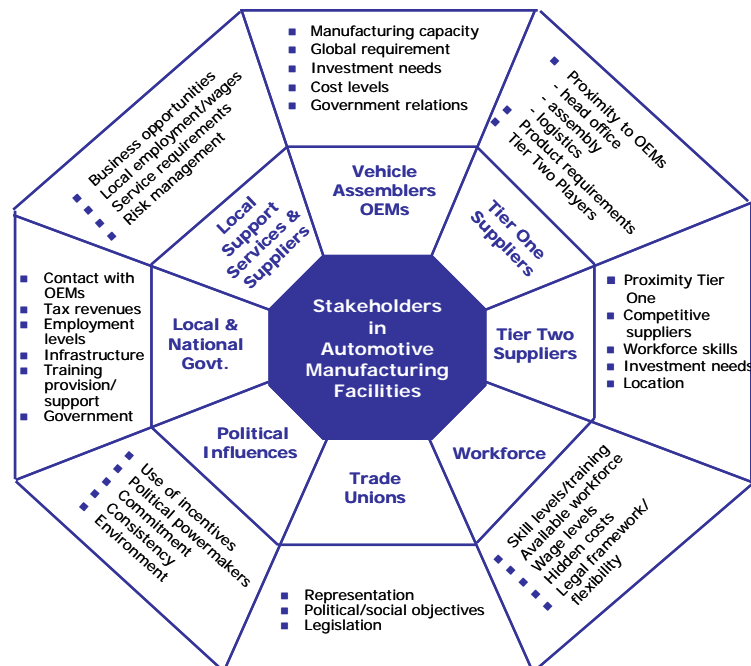
In essence, could there be the basis for a rejuvenated, refocused automotive industry in the United Kingdom - and perhaps the financial and automotive tsunami we are now entering may just be the catalyst necessary to propel the industry forward positively? The industry is on the cusp of a major change in terms of propulsion and new technologies and is in a pre-competitive stage with a large number of players examining and participating in network partnerships.

Industry vulnerability – business migration

The UK automotive industry is vulnerable on a number of fronts. Consider some of most immediate concern;

- A shift to the east – to CEE, Russia and further east of automotive components manufacturing, to be near to new assembly facilities being built by the OEMs to supply these new markets. Manufacturing, close to the end-user, offers flexibility of supply and reduced logistics costs as well as the opportunity to influence design and re-engineering.
- The loss of headquarters – global or regional – whether OEM or major Tier One components supplier, means there will be a loss of ‘ownership’ of business and a subsequent gravitational pull to move with those headquarters and decision-makers. There is also a natural movement for component suppliers to move with their customers.

Figure 2.8; Stakeholders in automotive manufacturing



Source; Chapter 2

Retention of these skills will be increasingly challenged

- The ultimate risk is that Research and Development, too, will move further. This is the key, the heart of the organisation – ideas, technologies, and future value-added revenue streams. Retention of these skills will become increasingly challenged as countries with new component and vehicle assemblies develop their own technologists and engineers to work on those products.

Hence the challenge to put 'clear blue water' between the UK and new, nascent skills bases.

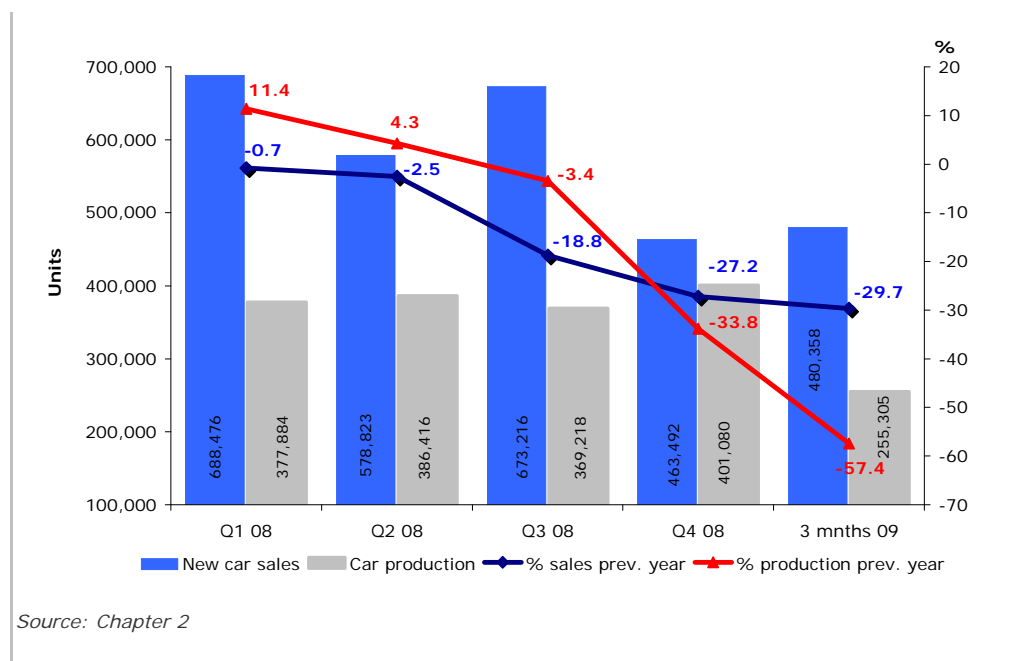
Consequences of inactivity – contract to manufacture

The consequences of this strategic hollowing out of the industry – a sort of 'technological cherry-picking, is that the United Kingdom has developed a unique automotive industry with a number of characteristics that may be found singly elsewhere, but, in total, are probably unique to the UK. Consider them;

The UK is very good at making highly-competitive products for other people

- There is vehicle manufacturing in the United Kingdom rather than a vehicle manufacturing industry. Thus, it is very good at making highly-competitive products for other people, who ultimately have little economic loyalty to the UK, particularly if there are more effective places to manufacture – and that effectiveness includes the cost of logistics as well.

Figure 2.13; UK new vehicle manufacturing and sales 2008 vs. 2007 (Jan/March 09)



- The UK is not necessarily the lowest cost of manufacture country on a long-term basis – perhaps it is at present, but part of that is due to currency fluctuations. Its benefits come through well-trained, flexible, good quality labour and a mature supply chain, all of which can be replicated over time by other countries. The UK advantage is one of time leadership – a few paces ahead of the chasing pack. The problem is being further compounded by the loss of intellectual property and research out of the UK, to be based near to the real decision points rather than close to assembly facilities.
- While the UK has flexibility in skills and working within its overseas-owned plants, the migration of markets and other elements of the supply and technology chains mean it is unlikely that further significant new production facilities will come to the UK or any other western European country.

- A major strategic challenge is, therefore, to maintain the current OEM and component activity to retain current assembly and component manufacturing. Such retention strategies need to be based on effective communication with the key players, the provision of services, support, labour and business environment they all demand – all in severe competition with other countries, currencies and governments.

To retain the automotive footprint and competitiveness will be a big challenge indeed; growing it significantly could, even for the most positive and optimistic, be regarded as an uphill task.

Realistically, the future of a viable automotive industry is dependent on being able to satisfy these demands. As noted previously, the industry supports 850,000 jobs and a globally competitive industry, even if that competitiveness is in specific niches. The demise of the automotive industry would represent an unthinkable doomsday economic scenario.

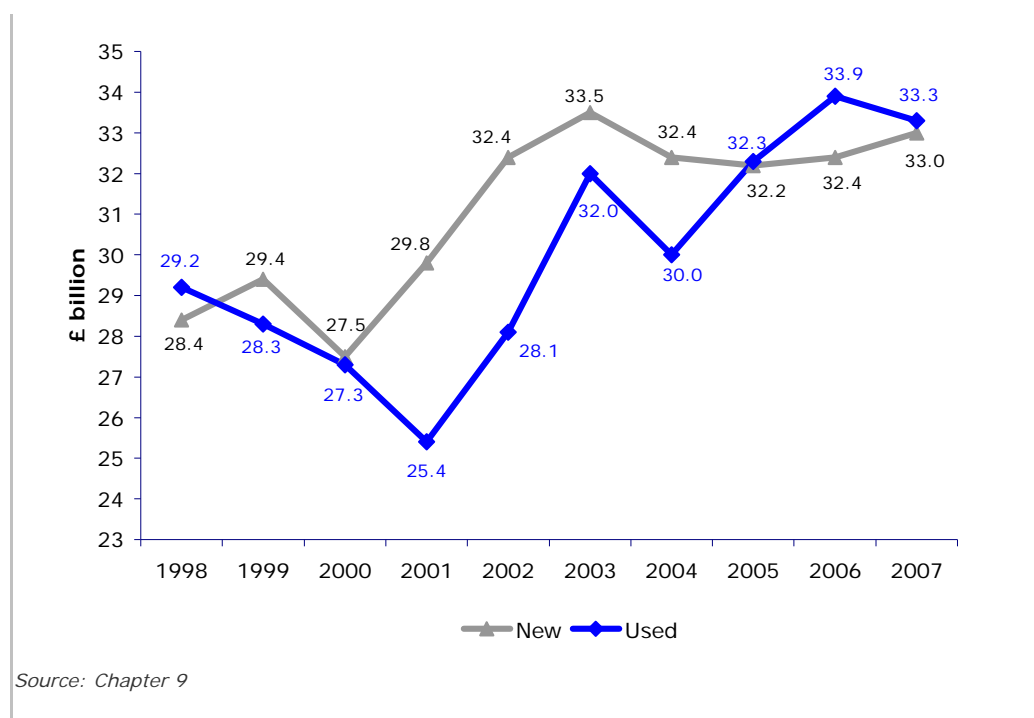
Centre of excellence – manufacturing, vehicle services and innovation

The United Kingdom probably has more than its share of strengths

In a global industry, few if any countries excel in every aspect of a particular industry. The same is probably true of the automotive industries. Yet, the United Kingdom probably has more than its share of strengths that can be exploited to retain and redevelop a major industry.

Some of these particular strengths apply to manufacturing, others are less easy to define in terms of modus operandi, while some give the UK automotive industry undoubted supremacy in vehicle service, support and management – albeit a difficult bundle of benefits to exploit internationally in terms of value for UK plc.

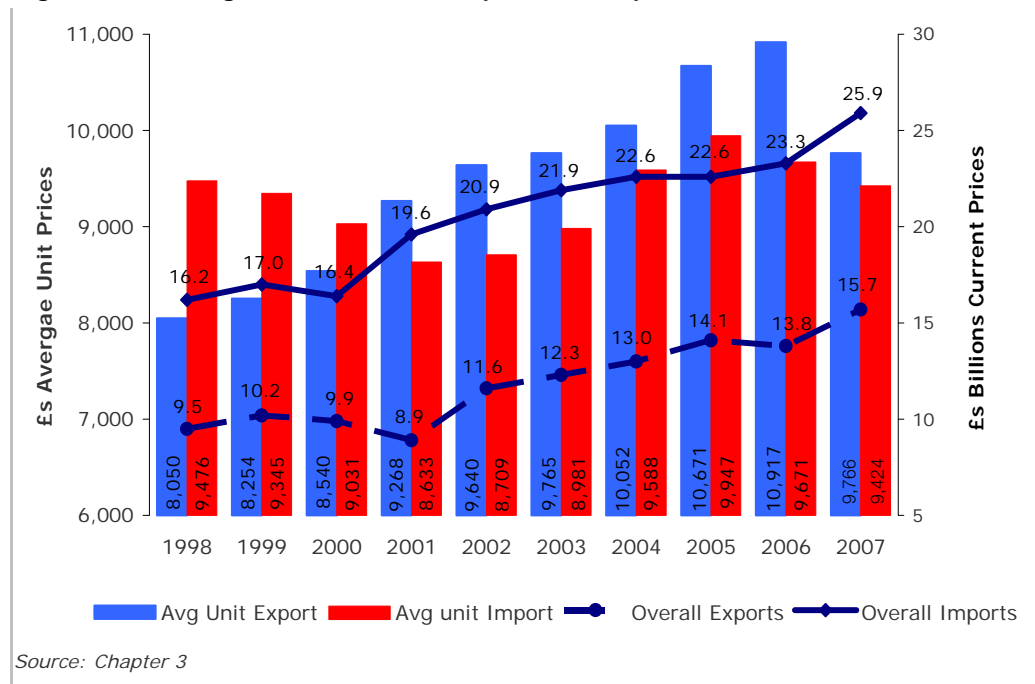
Figure 9.2; New car vs. used car market values



Consider some of these industry strengths – centres of excellence that may offer opportunities for future exploitation and development.

- Engine development and manufacture; the UK could be called ‘a preferred engine manufacturer to the global automotive industry’ three global players use the UK as a key base for their engine manufacture. How could that capability be widened and used elsewhere? Given the competitiveness of engine manufacture, why can’t these same skills be developed further in terms of vehicle assembly?

Figure 3.5; Average value of vehicle imports and exports; 1998 - 2007



- Vehicle retail and company car and vehicle finance; the UK is the European, probably the world leader in these increasingly important fields. On the one hand, they support a highly-competitive new car market of 2.0 to 2.5 million units a year and on the other, a seven million used car industry. As a nation that prides itself on selling financial services, is there a way we could sell these services to a wider market?
- The United Kingdom is the undisputed home of the world of Motor Sport and the Grand Prix industry – yet much of it is either foreign owned or foreign financed. Is there unidentified or under-exploited leverage in this industry that might be used to create further technological and market opportunities?
- Some of the world’s most sophisticated and prestigious vehicles are designed and built in the UK, even if ownership no longer rests in the country. No other country can claim a portfolio as prestigious as Rolls-Royce, Bentley, Aston Martin, Jaguar, Land Rover, McLaren, and Lotus – albeit none of them are UK owned. Given the growing sophistication in terms of market niches and reducing product life cycles, there is a clear message here.

The UK is the undisputed home of the world of Motor Sport

- A further and increasingly important plus-point for the United Kingdom is its inherent political and economic stability. While the country is about to enter what might be a deep recession, essentially it is a stable base for business development with no 'nasty shocks' of the sort that can easily deter potential investors.

It is against these essentially positive issues that the UK needs to be viewed strategically. However press and politicians might deride the automotive industry, it has a lot running for it. The clear challenge is – how can it be fully exploited?

Challenges for exploitation – scope for (pre) competitive cooperation

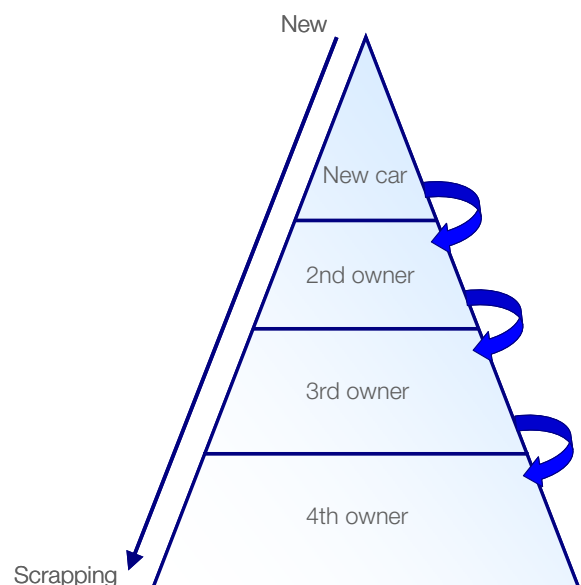
There are a number of challenges to be faced

There are a number of challenges to be faced (explored later in this report) that the industry and government have to come to grips with, if the breaking automotive tsunami is to be overcome and a new dynamic sector emerge for the second century of the industry.

If the financial and now imminent manufacturing meltdown and repositioning that have appeared are to be countered, a number of critical issues need to be addressed urgently, yet strategically;

- Is the industry at a tipping point where exports might decline and the UK become essentially an 'automotive importing nation' with the associated implications for the balance of payment and jobs; or does it wish to continue as a significant player in the global automotive industry?
- If the UK content of cars assembled in the UK automotive slips further, will there still be justification for global vehicle manufacturers to continue to regard the UK as a viable manufacturing base?
- How can the inherent strengths in the UK industry, some of which have been outlined and others that are touched on later, be leveraged to add business and strategic justification to the industry in terms of building on iconic brands and the things the industry does well?
- How does the UK automotive industry retain and grow its skills base at all levels from the factory floor through technologists to engineers. How does it grow its engineering and technology base? How does it consolidate these skills into technological portfolios or create excellence in targeted, developing sectors?

Figure 9.3; Used vehicle supply chain



Source; Chapter 9

- Is it possible to build IPR and value-added skills in a highly-fragmented and essentially independent industry through creating focus and attention – and investment on a number of highlighted industry sectors? Such emerging sectors as InfoTech, safety, new fuel sources among others.

In the absence of a range of UK-based Tier One players and headquarters, how might the UK create vehicles/mechanisms to sponsor research and development and technical development – with sufficient capacity and resource to fully exploit those activities?

Is there, or what might it take, to create an appetite among key players to consider investment back in the UK for R&D and development?

Government support – activism on key resource support for self help

Release the log-jam in terms of finance for new and used vehicle sales

Perhaps the most immediate support for the automotive sector is to release the log-jam in terms of finance for new and used vehicle sales. The recommendation is a simple one as shown in the bullet points below;

- Encourage finance sources to give high priority to releasing, prudently, funds for buyers to acquire both new and used cars and light commercial vehicles.
- Offer government support to ‘pump prime’ vehicle sales and support the retail motor industry and associated specialist businesses, while taking due care not to distort the market in the medium term or to prolong the weak market.

In terms of motor manufacturers and the components sector as well as the technology consultancies, requirements are longer term to support structural change.

Is it possible for the UK to reverse the trend, and grow the value of its automotive investment?

Quite simply, is it possible for UK plc to reverse the trend and grow the value of its automotive investment, or is it merely going to look to protect the current level? Equally important, if the UK automotive sector is not to be amongst the leaders, what might be done to attract more Tier Two and Tier 3 players to develop those programmes in the UK, rather than follow strategic assembly to developing BRIC countries?

There is a rising social and environmental challenge emerging among global automotive players that could offer new markets and business opportunities. What, if anything, might the UK do to exploit these new opportunities that are currently at a stage of exploitation – and develop a new level playing field for the industry?

The UK is at a balance point. There is a challenge for its automotive industry, whether an assembler, a components or a technology player of businesses involved in the provision of vehicles sales and services.

Does it want to restructure to compete successfully in the second century of the global automotive industry – or retire to a gentle backwater?

Equally, for government, there is a similar challenge. There will be many demands for funding and support to keep industries afloat. The automotive industry is not looking for a long-term subsidy to keep it afloat. Rather, it is looking for investment and support to enable it to reposition and be able to take on the best global competition in those areas where it has genuine strengths.

*A series of actions
requiring government
support*

A series of actions requiring government support are identified in the report. These are finite steps and not seeking subsidies to keep existing businesses afloat but to provide support for the industry to restructure for the 21st century. The challenge is a simple one – other national automotive industries have already opened negotiations with their governments for support to keep the existing industry alive and to help in reshaping for the future.

Specifically, the following requirements have been identified;

- Focus support during the critical phases of planning of model change to ensure retention of automotive manufacturing in the UK – including skills training, minimisation of bureaucracy and logistics enhancement.
- Support to identify needs for new technology in the automotive industry.
- Identify the skills required to be able to develop/exploit those innovative technologies.
- Identify the existing skills to be able to exploit those opportunities.
- Provide support to bring together those skills and businesses to create suitable organisations to exploit the opportunities
- Continue the support as long as necessary to achieve independence.
- Provide the necessary financial support for these actions – with a realistic payback period.

*Or is the United
Kingdom to be
allowed to slip
into a quiet
backwater?*

Quite simply, is the UK automotive industry to become a powerful force in terms of leading edge technology – or is it to be allowed to slip into a quiet backwater and buy all its requirements from overseas – with the financial, cultural and employment implications that will bring?

Discussions should continue between the industry and government to determine the most effective way to move the automotive industry forward.

Government support initiatives for the automotive sectors must be tightly focused to ensure they achieve strategic industry development and competitive objectives, and must not suffer accusations of supporting short-term political objectives. Strategic development support takes a broad spectrum of formats; can be expensive and the results may take time to come to fruition. However, one hopes that lessons have been learned from historic short-termism and the demise of a once global leading industry.

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