

## Trends in European Foreign Automotive Investments

a report by  
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Foreign investment figures in European countries have been showing dramatic changes lately. The automotive sector, the second largest industry in Europe, provides a good example of the changing environment. This article provides an explanation of those changes based upon the four forms of foreign direct investment (see *Box 1*). It also provides an overview of the new economic environment for the automotive retailers, suppliers and original equipment manufacturers (OEMs) (car manufacturers).

### Greenfield Investments

#### OEM and Suppliers' Greenfield Investments

Since the 1990s, OEMs have focused almost all of their greenfield investments in Eastern (or former Eastern) European countries. The advantages of investment in Eastern European countries are not only low labour costs and lucrative incentives, but also being located in potentially the largest economic growth market in Europe. This potential is further enforced by the fact that the Russian market can also easily be reached from this region. Drawbacks in central European countries are: poor road infrastructure, an unsound legal system, dubious ownership rights and civil service corruption (see *Table 1*).

European automotive suppliers are constantly forced by the OEMs to make cost reductions, which is why many are moving their manufacturing facilities to lower-cost countries. On the one hand, as suppliers are required to take on more product development responsibilities, they also need to be close to their customer base (i.e. development centres), which is why many remain in Western Europe. The other reason for setting up in the traditionally expensive manufacturing areas is the outsourcing and modularisation trend; OEMs only award the suppliers a contract if they are located close to the assembly plant. This allows them to deliver modules just-in-time and in sequence.

Investments of suppliers in the traditionally expensive regions are thus still significant. Most of them have

expanded their research and development (R&D) operations and assembly operations of OEMs are now complemented by suppliers who deliver directly to the line.

This trend, however, is also valid in the Eastern European (or former) regions. As most new assembly operations are located there, the Tier 1 suppliers are setting up operations to supply in sequence to the assembly line. In addition, Tier 2 and Tier 3 suppliers set up most of their new facilities in this region. With new machinery and low labour cost, the savings are multiplied.

#### The Retailers' Market

Foreign investment in automotive retail – or dealer outlets – is insignificant. Most of the dealers are independently owned and there is a consolidation trend in Europe. The objective is to reduce the dealer network and move to a Tier 1 and 2 dealership network. In essence, Tier 1 dealerships are responsible for a certain region and smaller outlets order the cars and parts via the regional dealerships.

The other aspect of the consolidation is multibrand dealerships. The OEMs' quest for cost-cutting will most likely result in the establishment of multiple-brand retail outlets, which are already common in the US. Combined dealerships are expected for Opel, Saab and Daewoo, and the Ford Premier Automotive Group (PAG) UK brands (Jaguar, Land Rover, and Aston Martin).

### Acquisitions – Consolidation of the Automotive Marketplace

#### The Case of the OEMs

Automotive companies acquire competitors for the following three fundamental reasons:

1. Branding and market coverage – in order to move upscale or downsize in a specific segment, it is sometimes more economical to acquire a brand than to build one from scratch. Traditionally, American and European automotive groups rely

**Box 1: Foreign Direct Investment**

There are four different types of foreign direct investment (FDI). The first is the establishment of new facilities, typically referred to as a 'greenfield investment'. In this instance, a foreign company sets up new operations with capital investment in fixed assets such as land, buildings and manufacturing equipment. When a company invests further in an existing foreign operation it is considered an expansion that, with regard to foreign investment, goes hand in hand with greenfield investment. Mergers and acquisitions are the second type of FDI – a foreign company acquires a company and/or its immaterial assets, such as trademarks and its customer base, in the recipient country through cash payment, stock swap or a combination of both. The most 'intangible' form of foreign investment is the transfer of technology and licensing. In this case, the foreign company acquires licensing for technology and there is, in essence, no major foreign capital involved. Finally, joint ventures occur when capital base and ownership are split between partners. Joint ventures are, in essence, a hybrid form of one of the three mentioned above.

- on this strategy, while Japanese companies prefer the path of internal growth and building new brands. (Toyota, for example, recently created the Scion brand for the younger public, alongside the luxury Lexus brand.)
2. Entering a geographic area – already existing dealership networks and brands have an inherent value in a certain geographic area, allowing for fast penetration. In South Korea, for example, traditionally a closed market for foreigners, all major automotive groups have bypassed the closed market by purchasing Korean companies (Nissan – Samsung, General Motors (GM) – Daewoo, DaimlerChrysler (DCX) – 10% in Hyundai).
  3. Economies of scale – through the ownership of a variety of brands and the expansion into different markets, as well as through sharing components and resources, automotive companies are able to share fixed costs, such as those involved with development, equipment and design expenses. The dilemma involved with this economy of scale is in retaining the essence of the brand whilst using the same modules and components in as many models as possible.
- Outsourcing trend – suppliers have more responsibility in the development of components and systems, the latter leading them to take over their own suppliers in order to control the systems design.
  - Cost squeeze – yearly price reductions drive the suppliers to consolidate their resources.
- In many cases, the consolidation boom did not provide necessary savings to offset the requested price reductions from the OEMs. Megasuppliers such as Tower Automotive, Federal Mogul and Valeo TRW, were trapped by liabilities (e.g. asbestos) and some filed for Chapter 11.<sup>1</sup> Other companies such as Lear, Johnson Controls, Faurecia and Magna were successful in providing system solutions for their customers and continue to thrive in this marketplace.

The consolidation trend will continue because many of the Tier 2 and Tier 3 European suppliers are privately owned European businesses (see *Table 3*).

**The Retailers Network**

Acquisitions of dealerships (or dealership groups) are limited as the European market is dominated by family-owned stores. The largest dealership group is Porsche Holdings, based in Salzburg, Austria, which controls around 300 dealerships in Western and Central Europe and employs around 11,000 people.

**The Case of the Automotive Suppliers**

- Globalisation of the market – the OEMs were building different cars on the same platform worldwide, requiring their suppliers to be nearby.

With the abolition of the EU block exemption, the European retail landscape will change dramatically with both dealer groups controlling multiple-brand franchises on the one hand, and OEMs taking full control of dealerships in major metropolitan markets on the other.

1. Chapter 11 is the part of the US Bankruptcy Code describing how a company or creditor can file for court protection. In the case of a corporation, reorganisation occurs under the existing management.

Table 1: Largest Recent OEM Greenfields

Company	Location	Year	Value (€)	Employment	Production/Activity
BMW	Leipzig, Germany	2001	1.2 billion	5,500	BMW 3 & 1 Series
BMW	Chichester, UK	2000	100 million	350	Rolls-Royce Phantom
BMW	Birmingham, UK	2000	476	1,500	Four-cylinder engine
Honda	Wiltshire, UK	2001	184 million	4,000	Honda Civic
Porsche	Leipzig, Germany	2001	130 million	740	Porsche Cayenne
VW	Molsheim, France	2001	38 million	200	Bugatti
VW	Dresden, Germany	2000	180 million	400	VW Phaeton
Toyota	Walbrzych, Poland	2000	400 million	130	Engine and transmission
Toyota	Jelcz-Laskowice, Poland	2001	170 million	350	Diesel engine
Toyota	Valenciennes, France	1998	610 million	2,200	Toyota Yaris
Toyota	Valenciennes, France	2000	100 million	50	Diesel engine
Toyota	Kalin Oveay, Turkey	2001	425 million	2,000	Toyota Corolla
Ford	Kocaeli, Turkey	2002	650 million	4,000	Ford Transit, Ford Transit Connect
Ford	St Petersburg, Russia	2002	150 million	850	Ford Focus
PSA/Toyota	Kolin, Czech Republic	2004	1.5 billion	3,000	Compact car
GM/AvtoVAZ	Togliatti, Russia	2002	332 million	1,200	Zhiguli/Niva
DaimlerChrysler	Koelleda, Germany	2001	244 million	500	Engine
DaimlerChrysler	Hambach, France	1998	420 million	800	Smart

Sources: Automotive News, Toyota Motor Europe, IBM-Plant Location International (IBM-PLI), Industrial Investment Council (IIC) Germany, Invest in France, Invest UK Alsace Development Agency, Flanders Foreign Investment Office (FFIO).

American dealership groups such as AutoNation and Sonic may lead the trend, possibly funding their consolidation efforts with European public offerings. Foreign investment (acquisitions) in retailing is expected to boom dramatically at the expense of small private dealerships. This may be accelerated by the OEMs who, contrary to failures in the US, are taking ownership of dealerships in metropolitan areas in Europe, at least where it is legally allowed.

### Expansions

#### Market Forces

On the one hand, automotive companies are constantly suffering from pressure to reduce costs despite the increased costs associated with the development and manufacturing of car models (cost increases).

On the other hand, market fragmentation squeezes volume manufacturers in their core segment as customers are choosing between luxury brands in the large and medium-sized segment and smaller but more voluminous cars in the small-car segment (volume decreases).

#### The European Foreign Investment Boom

The current foreign investment boom is a result of different market forces that are exemplified in Europe, making it the most competitive automotive market in the world.

Automotive companies suffer from continuing cost increases due to the following factors:

- the technological content and the cost of developing new models exponentially heightening R&D costs;
- the market is becoming more fragmented;
- luxury manufacturers are moving downstream with smaller vehicles (BMW 3 and 1 Series, Mercedes C and A Class, Volvo S60 and S40) or introducing new brands into the small-car segment (BMW – Mini, Mercedes – Smart) lowering the total volume for the mainstream manufacturers, thereby increasing the competition; and
- in order to retain their market share, mainstream manufacturers have reacted by acquiring luxury brands (VW – Bugatti, Lamborghini and Audi; Ford – Volvo, Land Rover, Aston Martin and Jaguar; GM – Saab; and Fiat – Lancia, Ferrari and Maserati) or establishing their own luxury brand (Toyota – Lexus).

#### Safeguarding the Small and Compact Segment Volume

- The small and compact segments are traditionally the largest automotive segment in Europe, mainly due to external factors such as smaller infrastructure and high fuel costs. As development and production cost do not differ much from those of larger cars, companies solved this cost

Table 2: Largest Recent European OEM Acquisitions

Company	Target	Owner	Year	Explanation
Ford	Land Rover	BMW	2000	Engineering and assembly plant (US\$1.2 billion)
Ford	Volvo	Volvo Truck	1998	Engineering, trade name and assembly plant (US\$6.5 billion)
BMW	Rolls-Royce	Vickers	2001	Only trademark (US\$75 million)
Private	Rover/MG	BMW	2000	BMW still owns engine plant (symbolic US\$1)
VW	Bentley	Vickers	2000	Trademark and Crewe assembly line
VW	Lamborghini	Private	1999	Trademark and assembly line
VW	Bugatti	Private	2001	Only trademark
GM	Fiat	Fiat	2000	20% ownership (US\$2.1 billion)
GM	Fiat	Fiat/GM	2000	50/50 purchase/engine
GM	Saab	Private	1998	100% ownership
GM	Daewoo	Creditors	2002	44.6% share of the company; 14.9% Suzuki; 10.6% Shangui Automotive; creditors, rest
Ferrari	Maserati	Fiat	2000	100% ownership
Renault	Dacia	Romanian Govt	2000	100% ownership
Banca Italiana	Ferrari/Maserati	Fiat	2000	38% share of the company (€775.2 million)
Magna	DCX Eurostar	DCX	2002	Acquisition assembly plant
DCX	Mitsubishi	Private	2000	37.7% share of the company

Source: Ffio, IBM-PLI, Automotive News

equation in the 1980s by placing their manufacturing facilities in then lower-cost countries such as Spain or Portugal.

- The hatchback and first-generation diesel engine were the champions of the 1980s (with the VW Golf as market leader). Segment growth is now completely determined by larger mono-volume cars in both segments with the Renault Scenic and Opel Zafira as segment leaders in the compact class and models such as the Ford Fusion and Opel Meriva in the small-car segment.
- Increased competition is now coming from Japanese transplants (e.g. Toyota Yaris) and Korean imports, the latter largely integrated in European automotive groups.

#### Flexible Manufacturing, Platform Sharing and Outsourcing Production

OEMs have utilised several methods to increase

productivity in their existing European plants:

- maximising capacity utilisation by building cars for different market segments on the same line – Ford, GM (Opel), PSA Peugeot-Citroën and Renault are in the process of investing extensively instead of massive investments in flexible manufacturing, which will reduce tooling costs in model change-overs and allow for quick changes in production depending on market demand (see Table 4);
- outsourcing of major components (modules) to Tier 1 suppliers – development and production outsourcing allows for cost sharing, and for the variable costs of OEMs to be based on a pay-on-production scheme. This scenario can only be made possible through greenfield investments close to or in the existing assembly line;
- an initial idea of VW, which has now been adopted by all OEMs, is the development of one platform for a variety of vehicles and brand-names across continents; and

Table 3: Top European Supplier Deals in 2002

Target	Buyer	Value (€ million)
Teksid (Italy)	Questor/JP Morgan/PE Partners/AIG	453
Varta (Auto Battery) (Germany)	Johnson Controls (US)	308
FTE Automotive (Germany)	Hg Capital (UK)	198
Conti Temic (Germany)	Continental (Germany) (40%)	188
Zeuna Starker (Germany)	Arvin Meritor (Germany) (final 51%)	75
Magnetti Marelli S. Electronici (Italy)	Mekfin (Italy)	62
Technofusion (Germany)	International Rectifier (US)	50

Source: PricewaterhouseCoopers

Table 4: Investments of Ford in Current Manufacturing Plants

Location	Amount (€)	Activity
Ford Valencia (Spain)	600 million	Retooling Fiesta, Ka & Mazda 2/new Duratec engines
Ford Köln (Germany)	530 million	Retooling Fiesta & Fusion
Ford Genk (Belgium)	900 million	Double flexible assembly lines: Focus, Mondeo, Galaxy
Ford Saarlouis (Germany)	8.7 million	Retooling focus
Ford Dagenham (UK)	600 million	Retooling diesel engines Ford/Peugeot
Ford Kocaeli (Turkey)	650 million	Assembly of Transit/Transit Connect

Source: Ford of Europe

- outsourcing of production, assembly and sometimes even the complete design of low-volume models to ‘coach manufacturers’ (see Table 5).

### Joint Ventures and Technology Licensing

#### Joint Ventures and Minority Interest

The latest European joint ventures are a result of the following three different business cases:

- Controlling interest in a company – shareholders in Japan with an interest greater than 33% in the company have full control of the company. In this way, Mazda is controlled by Ford, Nissan by Renault (France) and Mitsubishi by DCX (Germany). Minority shareholders (less than 25%) normally acquire a seat on the board of directors and have the advantage of sharing in the strategy issues and facilitate technology transfer. GM is a proponent of this strategy as exemplified by taking 20% share in Fiat (with an option to acquire the full company) and it already has a minority interest (20%) in Fuji (Subaru) and Suzuki.
- Technology transfer – European joint ventures motivated by technology transfer have recently increased in Europe. The latest joint ventures are two 50/50 joint ventures between Fiat and GM in powertrain and purchasing, the Ford/ZF joint venture for the transmission technology and the Ford-Peugeot joint venture for European diesel engines. Other joint ventures are formed in the suppliers sector, mainly to ease development costs.

- Capacity sharing – in this case, an assembly plant is shared as production capacity is not enough to justify the investment. Recent examples are the Toyota (1/3)/Peugeot-Citroën (2/3) assembly plant for the production of a compact car and the Mitsubishi/DCX joint venture in the Netherlands for the production of the Smart four-door and Mitsubishi small-car platform.

### Conclusion – What Determines Foreign Automotive Investment

Evaluating these automotive projects, it is obvious that supply and demand factors define the location of a greenfield investment. While the cost factor in many cases determines those projects (labour costs, incentives and general business environment), automotive companies take the size and region of the future growth market even more into consideration.

Expansion projects are determined by group strategy and allocation of capacity utilisation. Expansions by OEMs are mostly a result of keeping abreast of technology and production processes (replacement investments) and, in many cases, result in a reduction of employment. The latest acquisitions in the automotive manufacturing sector are more a result of seizing the opportunity (e.g. a company for sale or hovering at bankruptcy) than long-term planning. In the supplier sector, acquisitions were a result of the drive to globally provide systems and modules while, in the end, those focusing on their core competencies succeeded. Finally, joint ventures depend largely on technology issues such as minimal plant capacity or are a result of a lack in know-how or competencies, such as diesel technology. ■

Table 5: Coach Manufacturers in Europe

Manufacturer Model	
Karmann	Mercedes CLK Convertible & Coupé, Renault Megane Convertible, Audi 80 Convertible, Chrysler Crossfire
Pininfarina	Ford StreetKa, Alfa Romeo GTV & Spider, Mitsubishi Pajero & Peugeot 406 Coupé
Bertone	Opel Astra Cabrio
Magna	Saab 9-3 Cabrio, BMW X3 Series, Jeep Grand Cherokee, Chrysler Voyager, Mercedes E Class 4-Matic

Source: FFIO