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2005 KPMG Global Auto Executive Survey

A mood of caution prevails among automotive executives this year. This fourth consecutive tracking study found respondents less positive and more realistic than in the three previous years. Meanwhile, some issues that troubled executives in the past have diminished in importance. Overall, there is a shift toward the practical and "do-able" and away from what is impressive or entails unusual risk.

Among the notable trends, shifts, and strong perceptions were the following:

- Global overcapacity was less of a concern than in previous years.
- Japanese sales growth is maturing; market-share gains will come from Korean and, eventually, Chinese brands.
- Foreign maker and supplier investment in China will increase, but profits there might come under pressure. An eventual vehicle-maker shakeout in China appears likely.
- North American makers' loss of global market share will slow.
- Sales incentives are here to stay but won't increase much.
- Higher profits are slipping further into the future, to 2006 or 2007, and losses are expected to have have peaked, for the time being, back in 2003.
- Fuel efficiency is now a key industry issue.
- The comeback of the car will continue, while SUV, pickup, and minivan sales will stabilize at or near present levels for the next few years.
- Luxury vehicles will lose some appeal.
- The concern that the industry has parted company with consumer wants and needs is abating.
- Safety is a basic tenet to the industry now and will continue to be an ongoing major focus for consumers and manufacturers alike.
- Labor relations have entered a stable period.
- New technology will be as important as new models in attracting customers.

The 2005 survey, conducted in October and November 2004, is the fourth annual tracking study of automotive executive opinions. It consisted of 110 qualitative and 10 quantitative interviews of North American-, European-, and Asian-based executives from vehicle manufacturers (VMs) and Tier 1, 2, and 3 suppliers. Variations among groups of respondents are noted when they are statistically significant in comparison with past years.

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Survey Findings

Big Issues: Quality Reigns, Consumer Tastes Resolved for Now

Among the major issues ranked by respondents as being very important right now, product quality and new products are on the minds of auto executives. In the midst of an unprecedented turnover of new models, quality is ranked as extremely important by 91 percent of respondents, down slightly from 96 percent last year, and new products by 84 percent of respondents, up from 77 percent in 2003.

Which issues do you see as most important to the auto industry now?

(Importance 4 – 5 on a 5-point scale)

Source: 2005 KPMG Global Auto Executive Survey

"There is an intense drive toward higher-quality and higher-efficiency vehicles, longer warranty periods, reduced cost of life, and service," said one European Tier 1 executive. "We're putting a lot of emphasis on that."

The economy, tied for second place last year with new products, dropped to third this year but stayed at 77 percent. Consumer tastes, previously a major issue for respondents, dipped substantially this year. Ranked second in the survey's first two years with 73 percent and third last year (71 percent), it fell to seventh of eight issues in importance this year, with 47 percent. One plausible explanation: executives feel that, after years of lagging consumer perceptions, the industry has responded, producing a raft of new models and greatly increasing the variety of products available. With the return of exciting designs – even minivans are turning heads these days – the industry may feel it has the boring-product-line monkey off its back for the foreseeable future.

Meanwhile, environmental concerns have slowly but steadily risen during the last three years and now stand in fifth place with 58 percent, having passed regulatory concerns (56 percent), which stayed at the same level as in 2003. The major driver of this issue is very likely fallout from the high cost of oil and the desire for greater fuel efficiency, not pure "green" concerns such as global warming and greenhouse gases.

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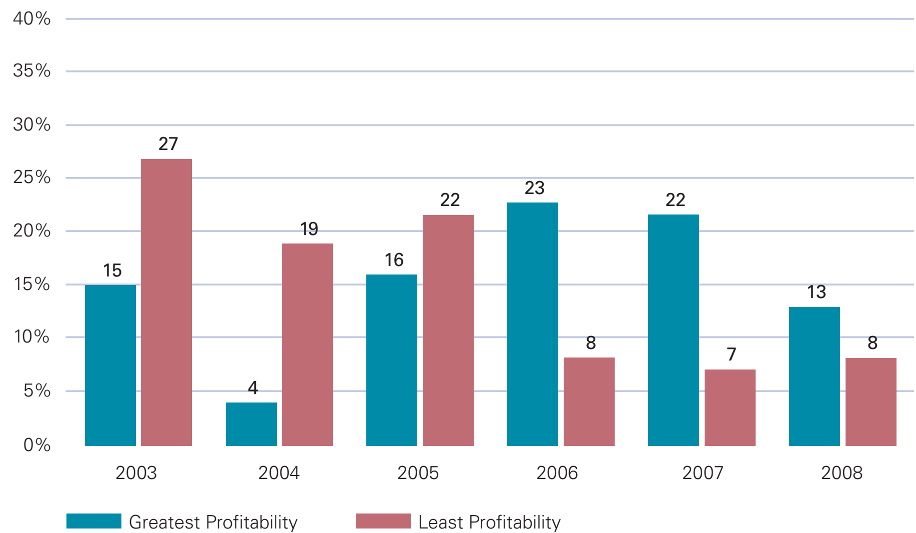
In addition, labor relations have fallen steadily from a high of 66 percent in 2003 to 45 percent this year, ranking eighth and last place in the issues category. Unions in both North America and Europe have been accommodating in the latest negotiations, and any needed cutbacks are being managed fairly amicably. Noted one North American Tier 1 executive, "Most of our labor reductions are currently being handled through rates of attrition."

Profit Expectations Weaker

With this year's record oil prices, conflicting measures of economic growth, rising interest rates, and the persistently weak U.S. dollar, respondents' expectations about profitability were decidedly mixed. No clear consensus emerged. The survey has typically noted that executives are most optimistic two to three years into the future and most critical of the current year. And indeed, like last year, more of this survey's respondents thought 2006 would produce the highest industry profits over the six-year span from 2003 to 2008.

For which of the following years do you expect overall auto industry profitability to be the greatest and the worst?



Source: 2005 KPMG Global Auto Executive Survey

This year, however, there are two countervailing trends in the results, both of which suggest growing pessimism about profitability: fewer executives than last year are looking for the highest profits in 2006 and more expect 2007 to be best, which is a significant decline. The number of participants who believed that the year of poorest economic performance for the industry was in the past (2003) dropped precipitously from 56 percent to 27 percent, while those who picked 2005 to be the poorest in economic performance nearly tripled from 8 percent last year to 22 percent. The year 2005 is now the second favorite choice for worst year from 2003 to 2008.

Most telling, profitability expectations for industry segments over the next five years are down sharply across the board, with the percentage of those saying VMs and dealers would be "most profitable" decreasing the most: VMs dropped from 53 percent last year to 28 percent. VMs are now in a virtual tie with Tier 1 for the first time in three years – last year VMs outpaced Tier 1 companies in expectations of profitability by 13 points.

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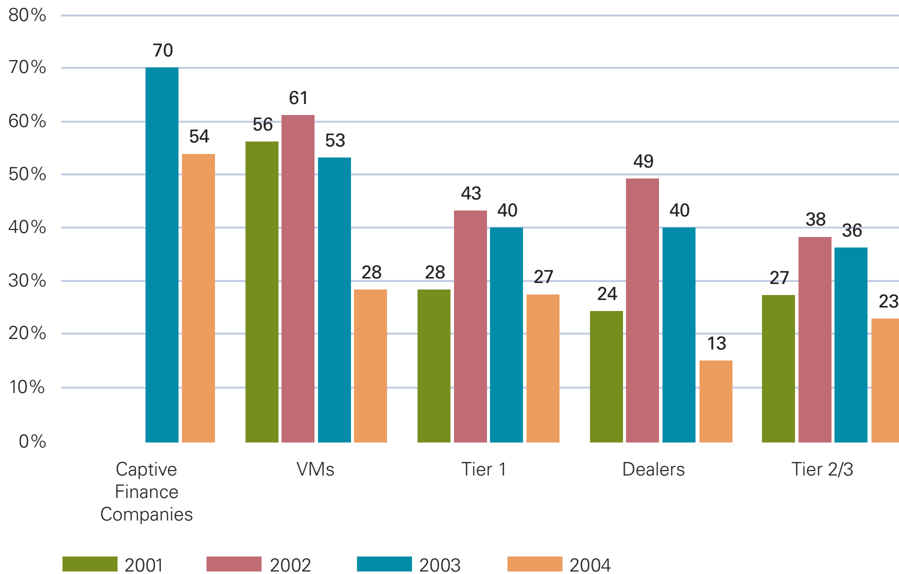
Which types of companies do you expect to be the most profitable over the next five years?
(Multiple answers accepted)



Source: 2005 KPMG Global Auto Executive Survey

In addition, dealers dropped from 40 percent to last place this year with just 13 percent of respondents saying the category would be "the most profitable." The leader, introduced to the survey last year, remains captive finance companies, but this category is down, too, from 70 percent to 54 percent this year.

One across-the-board explanation: rising steel, rubber and plastic costs coupled with increasing interest rates are likely to significantly cut into both profits and sales over the entire automotive supply chain. In addition, dealers could suffer from two trends: higher borrowing costs for new-car inventory as rates rise and lower incentives as VMs try to protect their own profits, which could lead to weaker sales. Dealers are already suffering from the Internet, not because of online sales but because of online information – consumers know more about prices and discounts before they set foot in a showroom.

The Global View: Asia Ascendant

There was a notable shift in the respondents' sense of global overcapacity: there was a general consensus that overcapacity was reducing. Like last year, nearly half think overcapacity is between 11 percent and 20 percent, but those who think it is 21 percent or higher fell from 35 percent to 22 percent, and those who think it is lower than 10 percent rose from 15 percent to 30 percent. With production climbing at many VMs, particularly Japanese and Korean makers, this shift would seem to indicate underlying confidence that global demand is rising and combined with reconstructing programs, overcapacity is being eroded.

Meanwhile, four out of five (79 percent) expect cross-border activity in the auto industry, such as "partnerships, manufacturing, sourcing, and other transactions," to continue to increase over the next five years. One incentive for "big players," noted a European Tier 1 executive, "is establishing business in underdeveloped markets." Chief among these are Asian countries, respondents believe: four of five executives strongly agree that "consumers in Asia will become a major source of growth in the global demand for automobiles between now and the end of the decade."

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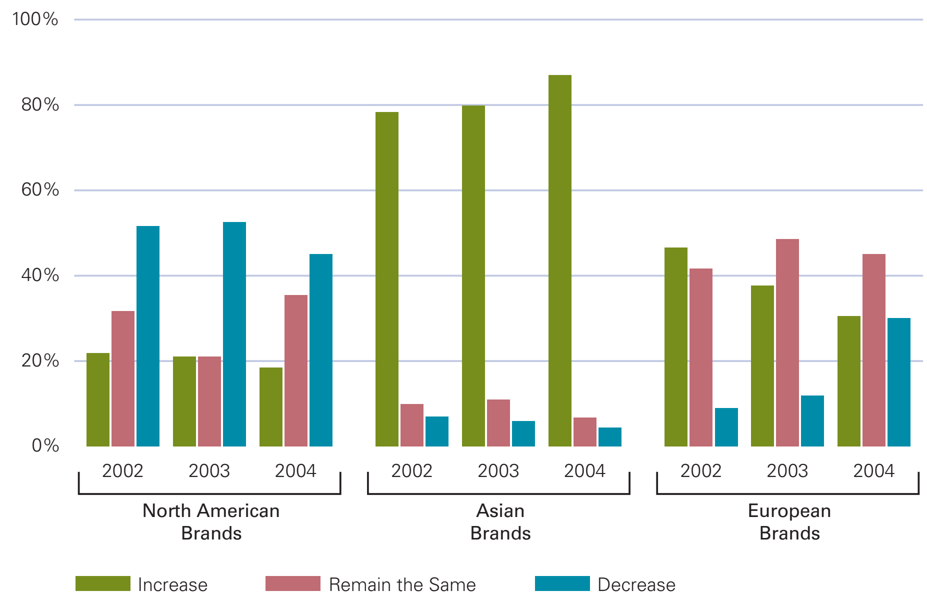
But Asian brands, say nearly nine of ten (87 percent), will absorb a disproportionate amount of this new demand. Interestingly, while auto executives overwhelmingly expect Japanese, Korean, and Chinese brands to gain share over the next five years, the biggest gainers are expected to be the Korean and Chinese – they are in a dead heat to gain, say four of five executives (73 percent), trailed by the Japanese at 53 percent.

Do you expect these area brands to increase, remain the same, or decrease in terms of global market share over the next five years?

(Responses may not total 100% since those indicating they do not know are not included)



Source: 2005 KPMG Global Auto Executive Survey

Are the aggressive growth goals stated recently by top management at two Japanese automakers overly ambitious? Perhaps not, but nearly half of respondents think that the Japanese manufacturers might fail to pick up more market share: 46 percent said Japanese brands will either stay the same or shrink in global market share over the next five years. This perception has been building over time and accelerating recently. In 2002, 70 percent of respondents strongly agreed with the statement that, looking ahead five years, "restructured Japanese automakers will continue to leverage greater efficiency into greater market share." Last year that number dipped slightly to 67 percent, but this year it has fallen to 52 percent.

Four of five (81 percent) thought North American brands likely to stay the same or decrease in global market share over the next five years, while 70 percent thought European brands would stay the same or decrease over the same period. Strikingly, only 19 percent thought North American brands would increase, compared with 30 percent for European brands; and 45 percent thought North American brands would decrease, while only 25 percent thought European brands would decrease. However, over the past three years respondents have grown more pessimistic about European brands, with those expecting global market share growth shrinking from 47 percent in 2002 to 30 percent this year, and those expecting global share loss for Europeans rising from 9 percent in 2002 to 25 percent this year. These trends are slightly reversed for North American brands the last two years, with fewer executives expecting them to lose global share (53 percent last year, 45 percent this year) and more expecting that they will hold their own (21 percent last year, 36 percent this year).

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Is there cause for this slight and narrow upturn in optimism for North American brands? Noted a North American Tier 1 executive, “The Big Three offer some advantages in terms of the models they make. There is a great variety and selection.” But a North American VM executive offered a darker view: “We’ve failed to meet what we call overseas market conditions,” referring to the variety of tastes and circumstances in markets around the world. “We just feel that what we make should fit everybody’s taste. I think this had hurt us a lot.” Echoed a North American Tier 2 observer, the Big Three needs “investment, not just to compete, but to catch up.” However, the number of respondents who think the Big Three can catch up has been declining: since 2002 fewer believe the Big Three will become “more efficient and competitive” looking ahead five years – 56 percent that year, 50 percent in 2003, 39 percent this year. Of note: European respondents are significantly less likely to think U.S. automakers will become more competitive than their North American counterparts.

Industrywide, however, executives have increased their expectations that the product development cycle will “decrease dramatically” over the next five years. This number held steady in 2002 and 2003 at just under half (45 percent and 48 percent) but jumped this year to 63 percent.

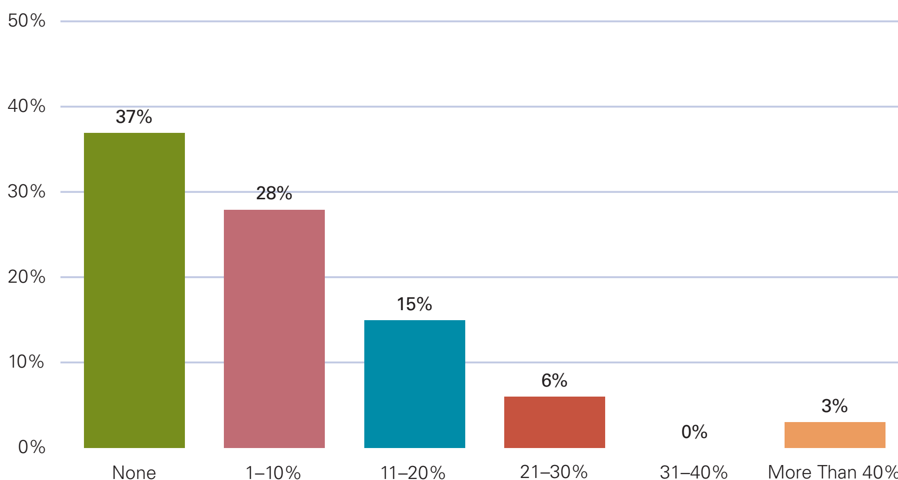
The Elephant in the Room

How important is China to the future of the global automotive industry? As one North American Tier 1 executive put it, “China is not a choice, it is something that you have to do to survive.” The size of the Chinese population alone indicates “a lot of potential for market growth,” according to one North American VM executive. Major suppliers are mounting operations there to be closer to their VM customers, who in turn are partnering with Chinese manufacturers (as Chinese regulators so far require) to provide broader and deeper product offerings.

What’s clear is the very high degree of consensus among respondents about the future course of the global industry’s investment in China: 85 percent expect an increase over the next five years – that is, investment above and beyond the industry’s current heavy level.

Largely because of the tremendous wealth created in China among an elite over the past decade, the luxury passenger-car segment has taken off.

In your opinion, how much overcapacity is there in the Chinese automotive industry?



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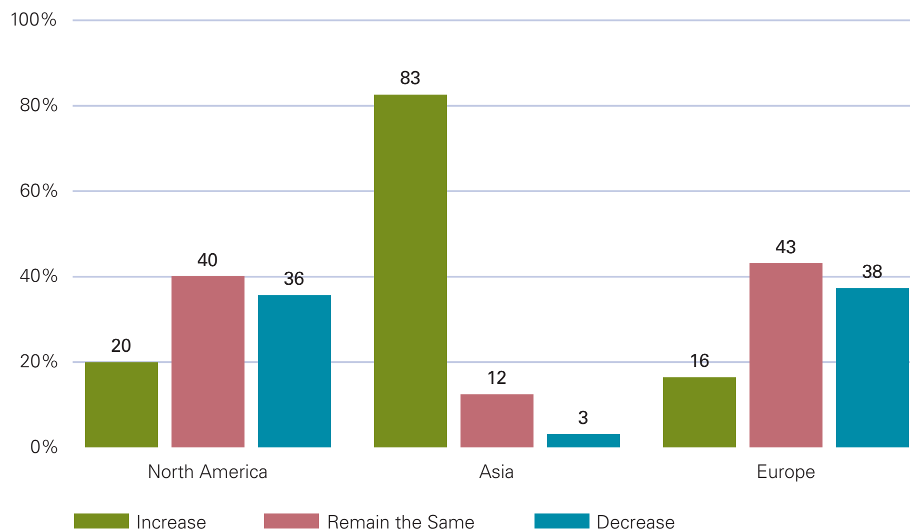
But only 26 percent of respondents think Chinese consumers will spend more on luxury cars than on economy cars over the next five years, and 52 percent feel the reverse will be true. As one European Tier 1 executive noted, "The [Chinese] middle class will grow, and they will buy cars, but not so fast." This sentiment helps explain that while 55 percent think profitability from Chinese operations will increase over the next five years, 43 percent expect it to stay the same or decrease, and 23 percent of that is "decrease."

Do you expect the building of new manufacturing facilities in the following areas to increase, remain the same, or decrease over the next five years?



Source: 2005 KPMG Global Auto Executive Survey

Moreover, only 32 percent strongly agree that Chinese markets will be "highly profitable" in the next five years. "I think growth has been too quick," stated a European Tier 1 executive, "particularly this year and last year." Chinese authorities apparently agree: they have been trying to reign in the economy by squeezing credit and other measures for the last half-year. Significant levels of capacity have been installed in China and more is committed by a number of manufacturers. However, there was not significant concern among respondents that excess capacity would be a problem in China. But this does not mean smooth sailing for all VMs now in China: 55 percent of respondents think a significant shakeout is coming, after which "only a few strong competitors will remain," and 63 percent feel that means six or fewer non-Chinese VMs, with just 13 percent expecting more than ten non-Chinese VMs in the country in five years. Causes cited include lack of real productivity in Chinese plants, lack of raw materials, high transport costs, concerns about the vulnerability of intellectual property under current Chinese law, and the business risks of a radical change in direction within the government's powerful central authority.

With such worries, why are non-Chinese auto companies so eagerly investing in China? To tap the vast Chinese market, of course – 45 percent of respondents said that is the most important reason. But 35 percent apparently view China as a manufacturing opportunity and a source of profitable exports at some stage in the future. And nearly two in five said addressing the Chinese market and taking advantage of cheap Chinese labor for export are equally important to them. And non-Chinese firms won't be the only exporters. Long term – or as soon as next year, if you credit several very aggressive Chinese automotive entrepreneurs – Chinese companies will become "more international," according to one European Tier 1 executive.

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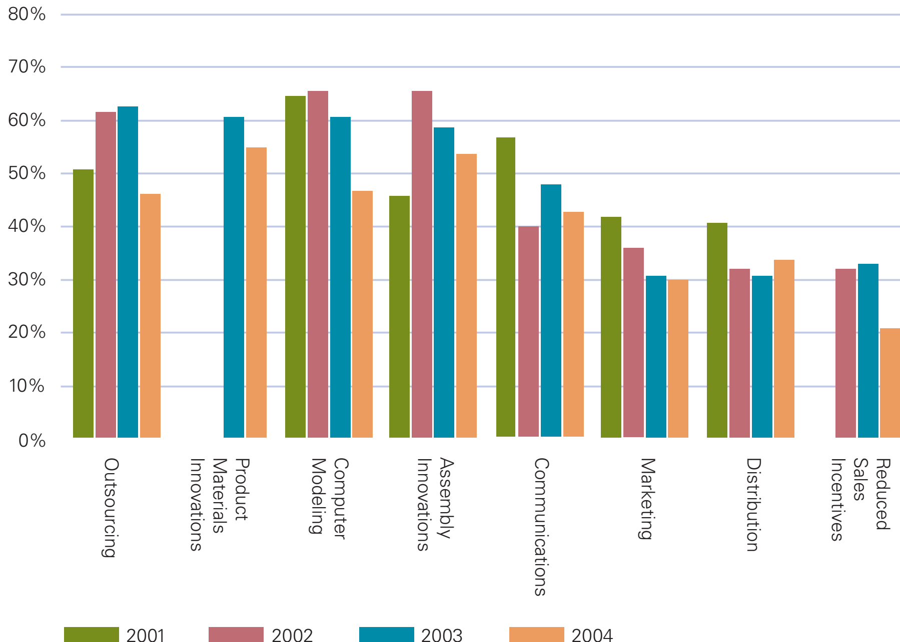
As carmakers focus more attention on Asia, where do they expect new manufacturing facilities to sprout? Not surprisingly, 83 percent of respondents said new plants would increase in Asia, but only 20 percent said more plants would be built in North America, and 16 percent said more in Europe. Slightly more than one in three said the number of plants in North America and Europe would actually decrease over the next five years. And in China, the biggest Asian growth market by far, fully half of respondents thought Asian makers had the best chance of succeeding over the next five years, compared with 19 percent for North American companies and 25 percent for Europeans.

Cost Savings from Innovation

How to compete? *Lower costs*, among primary points of difference. Perceptions of where cost savings may to be found in the near future have shifted, according to respondents, who are less sanguine about opportunities for cost savings overall this year. The top two areas are innovations in product materials (55 percent) and assembly innovations (54 percent), which have been among the top two or three in past years.

How great an opportunity for future cost savings do each of the following areas offer auto manufacturers and suppliers?

(Opportunity 4 – 5 on a 5-point scale)



Source: 2005 KPMG Global Auto Executive Survey

The biggest suppliers, too, are thinking hard about manufacturing advances. “Cost savings are going to come not only from choosing the lowest costs for operations but also from innovation,” observed a North American Tier 1 executive. “We need to reduce labor costs, but we also have to develop the sophistication of our production.”

Computer modeling and outsourcing have both slipped this year as sources of new future cost savings, each more than ten points. However, Tier 1 respondents were significantly more likely to find a “major opportunity” for cost savings in outsourcing than were VM executives, perhaps because suppliers tend to be further behind the outsourcing curve than VMs. Communications (internal e-commerce via intranet/extranet) follows as a close fifth. Distribution, tied last year with marketing, rose a slight four points to pass marketing this year. In a significant drop, reduced sales incentives, at or very near the last source for cost savings in the past two surveys, dropped 11 points to finish last on the list – a clear indication that executives feel the era of major sales incentives will continue.

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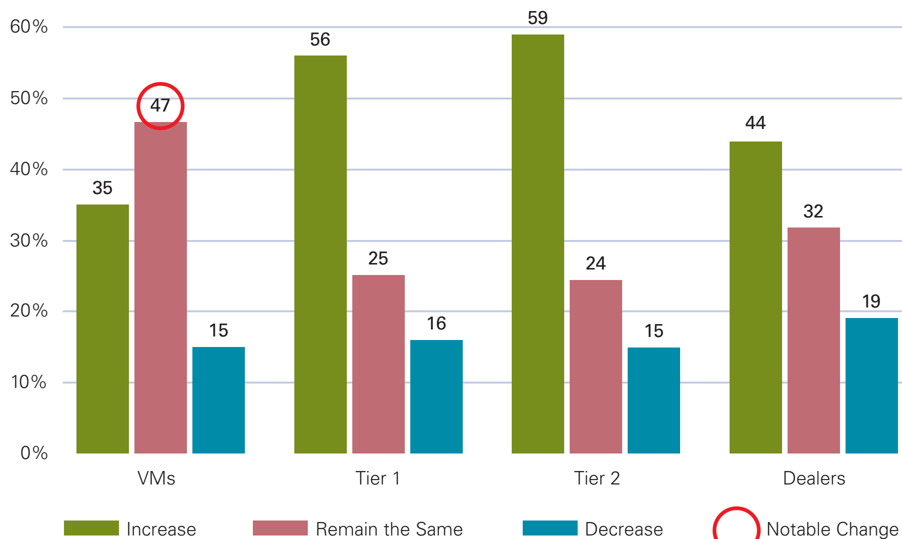
Consolidation, traditionally a response to industrywide cost pressures, is being viewed this year with considerably less enthusiasm than in the last survey. It is thought to be a bit more likely to occur in emerging markets than in established ones. More respondents expect an increase in M&A activity in Asia (70 percent) than in Europe (49 percent) or North America (39 percent), which shows a significant drop in that number from 50 percent last year. About half (51 percent) think the rate of consolidation will remain the same in North America for the next five years, compared with 32 percent for Europe, where the largest percentage of the three choices – 17 percent – thinks the rate of consolidation will actually *decrease* over the next few years. Among the four targeted industry groups – VMs, Tier 1, Tier 2, and dealers – the expectation among three of five respondents for increased consolidation is still concentrated on Tier 1 and Tier 2 companies in numbers almost identical to those of last year. But VMs are viewed as more likely to stay the same or experience less consolidation (62 percent) than to see increased consolidation (35 percent). Dealers, too, edged toward a lower rate of consolidation in respondents' expectations, but the growth of mega-dealers via acquisition will continue nearly unabated, in the opinion of executives.

Do you expect consolidation among the following types of companies in increase, remain the same, or decrease in terms of global market share over the next five years?



Source: 2005 KPMG Global Auto Executive Survey

Even though the urge to consolidate has waned sharply in this year's responses, the emphasis on various levers of consolidation has not shifted significantly in a year – cost pressure and lack of profitability remain primary, economic recovery is last. Specifically, spurs to strategic realignments continue to favor negatives rather than opportunities in the minds of respondents: cost pressure (62 percent), lack of profitability (56 percent), and poor financial performance (40 percent), with some positives not ruled out, such as potential synergies (40 percent) and access to new markets (39 percent). But sizable economic improvements, which fall at the bottom of the list, are viewed as not likely: global economic recovery (28 percent) and regional economic recovery (25 percent). Meanwhile, cooperative ventures got the vote over M&A (55 percent) looking ahead five years, the same as in 2003. This steady state compares with 72 percent in 2002. This is surely another sign that the industry has taken on a more conservative, less risk-taking mood.

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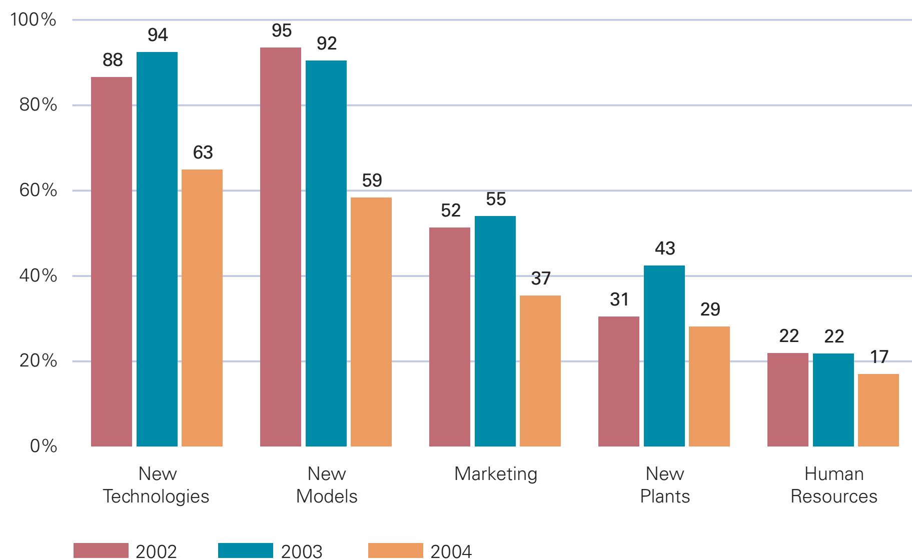

Source: 2005 KPMG Global Auto Executive Survey

Investment Climate Turning Wintry

Further evidence of widespread caution is found in responses to areas where manufacturers are likely to place bigger bets in the future. For the past two years the clear winners by 25 to 40 points over the next nearest choice have been new models and new technologies, with new technologies overtaking new models last year by a hair. This year that trend continues as new technologies, such as anti-rollover systems and voice-activated functions, perhaps seem more effective than new models in forging differentiation in a noisy and cluttered marketplace. But notably the response percentages dropped across the board this year. Is this a test anomaly or a significant mood shift? Only a comparison with next year's results can provide a solid answer, but one good explanation might well be that executives this year are wary of future *increases* in any investment under the coming economic climate, and that's what the question asks. The fact that the *priority* of investments has not changed in three years strongly suggests that there is indeed a shift toward a more conservative worldview.

As the balance between cost cutting and vital investment is struck (and restruck) within companies, will the industry's balance of power shift much among VMs and Tier 1, 2, and 3 suppliers? Only 35 percent agreed strongly that VMs are evolving into marketing-focused organizations, with research and development and manufacturing coming from the supply chain – a number that has not gained or lost significantly in four consecutive years. Notes a North American Tier 2 executive, "There's an absolute battle being waged. The Tier 1 and 2 suppliers, even today, are not strong enough to challenge the Big Three. But that day is going to come." A North American Tier I executive concurs, at least for now: "If one Tier 1 says they cannot do something, the VMs will find one that can. The VMs will maintain their leverage."

On a positive note, labor seems to be steadily declining as an issue of concern among a broad range of respondents from very high to something approaching moderate. Asked if they thought there would continue to be major increases in the cost of pensions, heathcare, and legal services, 66 percent strongly agreed, down from 85 percent in 2002 and 76 percent in 2003. The alarm has been clanging in the press; perhaps

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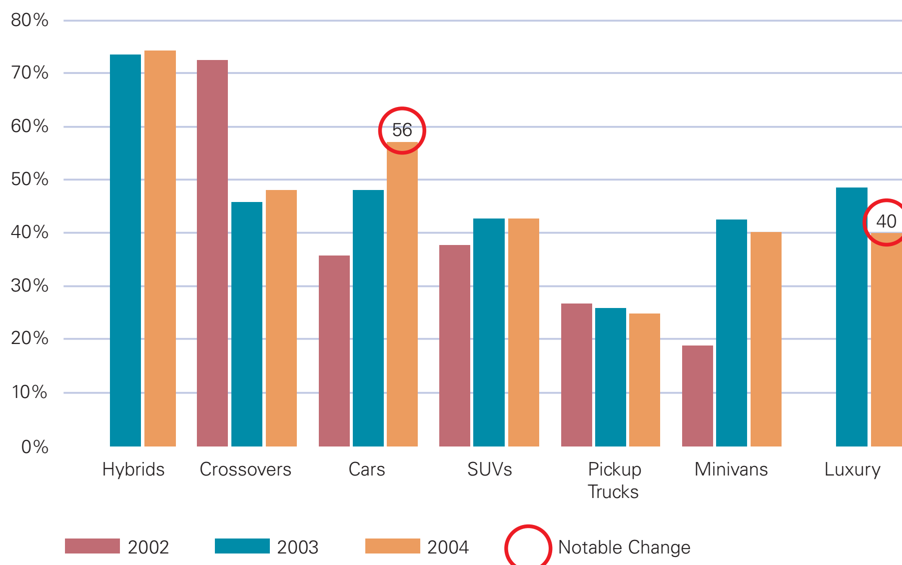
executives now feel the process of reducing the pensions burden on companies has begun. And across an array of insistent industry issues, labor relations is considered this year among the least significant.

Model Mix: Affordable Cars and More of Them

When asked which vehicle categories are likely to increase in share the next half decade, respondents determined that the year of the crossover was 2002 (73 percent). This was the year of the hybrid (74 percent), making 2003 for the hybrid (73 percent) no fluke. Next year could be the year of the car, which has been steadily rising over the past three years from 36 percent in 2002 to 56 percent this year. SUVs and minivans, which rose sharply in 2003, have both leveled with only two of five saying the categories will increase over five years. Pickups are holding steady year to year with one quarter of respondents seeing an increase. The one significant drop this year was in the luxury category, which fell from 48 percent to 40 percent, again indicating that the free-spending consumers to whom the automotive marketplace has enjoyed catering since the mid-1990s are expected to pull back. Two categories added this year emphasize that impression: low-cost cars came in at 66 percent, second in rank, and super-luxury at 29 percent, just above last-place pickup trucks.

In terms of global market share, do you expect the following categories of vehicles to increase, remain the same, or decrease over five years?

(Percentage expecting increase)



Source: 2005 KPMG Global Auto Executive Survey

Hybrids, once a fringe category with just two brands, both Japanese, and two smallish models with big price premiums for the exotic technology – a grand symbolic gesture, in other words – are coming into their own. One Detroit brand has joined the fray with a very credible midsize SUV that is a true hybrid, and a full-size SUV Japanese hybrid, due this spring, is reportedly already on back order. Other SUVs are on the way. Even European brands, which have been stubbornly insisting that diesel is a smarter solution to both escalating fuel costs and environmental concerns, are feverishly working on their own versions of hybrid technology or preparing to license one. The shift in industry attitude is palpable. In 2002, 46 percent of respondents thought there would be "a major increase" in U.S. sales of alternative-fuel or hybrid cars. The number fell slightly last year to 43 percent but jumped this year to 58 percent. And 54 percent said they strongly expect an increase in "consumer acceptance of hybrid vehicles" over the next five years, while only 13 percent expect a decrease in acceptance.

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The comeback of the car, predicted in the survey since its low of 36 percent in 2002, appears to be as much a function of rising global demand for practical, economical transportation as the energetic and adept attempt by the Big Three to retake car market share from the dominant Asians, mainly Japanese but with an onrush of Korean models. The recent success of several new sedans from the Big Three and the expected strong sales of more Big Three sedan launches next year tend to overshadow the market's move to, as a North American Tier 2 executive put it, "reasonably priced, fairly efficient models." In agreement, a European Tier 1 executive elaborated, citing a modest French sedan assembled in Romania: "The quality is quite good and the price is low – 7,500 euros. This kind of car," he continued, "can even be sold in Western European countries, even without extras like air conditioning and automatic windows. There is a big market for this kind of car, and there will be more of them."

Of the following automotive product innovations, which do you believe will be the three most important to the industry over the next five years?
(Multiple answers accepted)

Source: 2005 KPMG Global Auto Executive Survey

As growth returns to the global economy, often at a quicker pace in developing countries than in the industrial West, efficient, affordable vehicles are likely to be the transportation of choice – and another reason why executives expect vigorous growth from Korean and Chinese automakers.

Technology Rising

Technological innovation, once the domain of American and European companies, now also comes from Japan, and with increasing frequency, executives believe. Companies there, said a European Tier 1 executive, "have pretty much changed how we do everything. Only they do it a lot better most of the time."

Since executives feel that innovations are a primary selling edge, where do they think the best ideas will emerge? Safety has long led this category, in which respondents are asked to choose three of the six technology areas that will lead in innovation over the next half decade.

Peaking at 82 percent last year, 20 points ahead of fuel cells and 24 points ahead of engine management systems, safety fell into a dead heat with fuel cells this year.

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Telematics rose to third, just slightly ahead of engine management systems. A new category this year, unconventional materials (replacing 42-volt systems), registered fifth and drive-by-wire electronics, third among priorities back in 2002, fell to last. As elsewhere in this survey, the notion that fuel prices are starting to alter the habits and perceptions of consumers is having an effect here. Meanwhile, the industry would seem to feel that major safety issues are being resolved and that the era of being on the safety defensive may finally be starting to fade.

The weight of innovation over the last few years has been electronic, but this year only 47 percent strongly feel that the share of a car's value coming from its electronic components will increase dramatically over the next half-decade. That is a big drop from 2002 and 2003, when 76 percent of respondents agreed with the statement. Noted one Tier 1 executive from a European company, "Electronics are important, but mechanical components are very easy to diagnose when there is a problem." Major safety advances – airbags, antilock brakes, stability control – would not have been possible without electronics, but the next level – replacing hydraulic systems with electronically controlled actuators for braking and steering – may be starting to look expensive and risky. And consumers have rarely declared electronic radios, climate-control systems, and powerful but complex navigation devices unqualified successes. On the contrary, at least one European maker declared recently that it had become too fond of electronic gizmos and was cutting back.

Consumer Preferences

What do executives think are important purchase criteria for consumers? The picture has not changed much since the survey's debut four years ago, but a few shifts are evident. They suggest that the industry has been listening to consumers, if only through its own filter of what really matters, and that several underlying trends may be taking hold. The results here mesh with what respondents said were the key industry issues.

Over three years, quality has been the top criterion among respondents for their sense of why people buy cars. Affordability and safety dueled for second place in 2002 and 2003, but this year fuel efficiency held steady since last year at 77 percent while the safety category dropped eight points to 75 percent and affordability fell to 67 percent from 78 percent. Executives are clearly concerned that high fuel prices and vehicles that are not particularly fuel-efficient could hurt the car business. Affordability may be less of an issue now that sales incentives have crept throughout the industry. And indeed, the sales incentives category, which had been as high as fourth in purchase criteria (70 percent in 2002), slipped this year to less than half (46 percent). In a separate question, just 35 percent of respondents this year said they strongly expected future increases in sales incentives, compared with 38 percent last year and nearly half (48 percent) in 2002.

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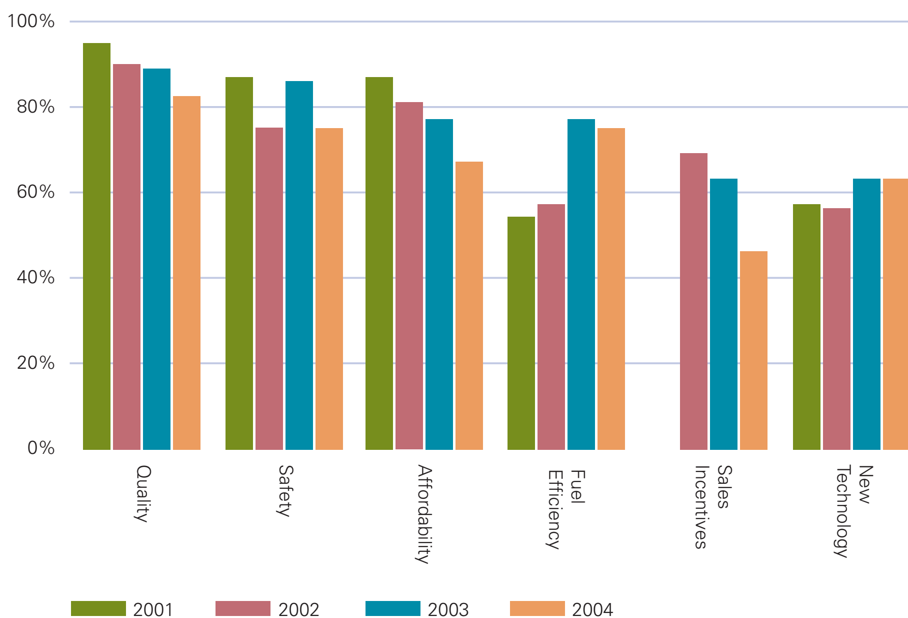
Other notable shifts include a plummet for luxury from 53 percent to 35 percent, a drop back from a small spike for serviceability (49 percent to 59 percent to 51 percent this year), a slip for alternative fuels after a major gain in 2003 (28 percent to 50 percent to 41 percent), and a hold for wireless communications at 30 percent after a climb from 21 percent in 2002.

Why has fuel efficiency become (by default) the second most important purchase criterion in respondents' minds? High oil prices, to be sure, and a slackening of demand for certain light trucks and SUVs with poor fuel economy. Three quarters of respondents agreed strongly that high petroleum prices will have a "significant impact" on the types of vehicles people buy over the next five years, and fewer than one in ten strongly disagreed. "Once fuel costs hit a certain breakpoint," said a North American Tier 1 executive, "it's only going to be the wealthiest buying SUVs and cars." But the incipient and perhaps growing desire for better fuel efficiency will not translate to a charge of environmental irresponsibility, executives believe. At a level identical with the two previous years, only two in five respondents felt strongly there would be an increase in "public concern that automobiles contribute to the threat of poor air quality and global warming," although significantly more VM respondents thought such public concern would increase than did Tier 1 respondents.

How important do you expect each of the following issues to be to consumers' purchasing decisions over the next five years?
(Importance 4 – 5 on a 5-point scale)



Source: 2005 KPMG Global Auto Executive Survey

In other environment-related findings, the number of respondents who anticipate an increase in recycling efforts has fallen sharply to 37 percent this year after starting at 51 percent in 2002 and rising to 63 percent last year. But North American respondents were more likely to see more recycling in the future than were Europeans, where automotive recycling has been mandated by law. "As we perfect that technology and it becomes more mainstream," said a North American VM executive, "we will see a whole new set of regulations… and it makes good sense."

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Conclusion: Challenges Ahead in the Global Showroom

It should be no surprise that this year's survey uncovered caution and pessimism in the automobile industry, or that there is no lack of resolve. Conducted during the final days of a highly contentious U.S. presidential election campaign and with the Iraq War encountering fresh difficulties, the survey also felt the chill of global economies showing signs of strength in some sectors yet continued weakness in others, concern over the robustness of consumer demand and sharply higher oil and other commodity prices.

Executives are taking to heart that things could very well get tougher. Incentives are a way of life, which means so are narrow profit margins. Cost savings of any magnitude will require new ideas, creative development, and production innovation, not simply a sharp knife wielded dispassionately in aging, flabby operations. The promise of the miracle of consolidation is being viewed with some suspicion, and in any case offers hope mostly to solve problems, not to produce opportunities.

At the same time, consumers are excited again about sheet metal. Cars are pushing "go" buttons in pop culture. Executives know they have passed a crucial test, crossed a critical threshold – even gearheads are starting to trust that mass manufacturers can come up with soul-stirring machines. The industry knows this is only a beginning, however, and that competition to capture the popular imagination is, and probably always will be, unrelenting.

Unmistakably, respondents acknowledge, the car industry today is global. Long warranties, once common only in North America, are now used in most major regions as a sales tool. Retail incentives are in the kit of every marketing executive and demanded by every dealer of his or her manufacturer, from Berlin to Beijing. VMs are starting to build true world cars – not world models, the panacea of the 1980s – world platforms that readily address varying regional and cultural tastes in the form of different models and variants. As a result, new-model development time, complexity, and expense all continue to shrink. (The vehicle you configure and order by Web site, like a custom-built home computer, is still a distant prospect, but no less bright.)

Perhaps the edge of gloom that has crept in this year is nothing more than a sobering realization: there is nowhere to run, nowhere to hide. Wherever they work, whatever regulations they are wrestling with, whichever customers they are struggling to anticipate and serve, automotive executives four years into the twenty-first century perform on a stage as large – and as small – as the world. A bitter rival once an ocean and an unfathomable cultural divide away is now next door and ready for lunch – if at all possible, yours.

But hunger can be quite motivating, and executives in this year's survey, while by no means sanguine, seem to be signaling that the difficult struggle ahead is winnable. They are, as others have shown before, exactly right.

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Under the auspices of KPMG's Automotive practice, Applied Research & Consulting LLC (ARC) conducted 110 quantitative interviews with executives, 50 based in North America and 60 based in Europe and Asia. Of these, 87 worked for suppliers and 23 for vehicle manufacturers. In addition, ARC conducted ten in-depth qualitative interviews with senior executives, five based in North America and five based in Europe. Of these, eight worked for suppliers and two for vehicle manufacturers. Findings from the two types of interviews show a high degree of correlation.

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