

Changing lanes 2015-16

The automotive C-suite's agenda



EY

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Executive summary

Auto companies need to strengthen preparedness, execution and resource alignment

>50%

of respondents are impacted by currency fluctuations, but only 15% feel well-prepared

2/3

of suppliers feel well-prepared to support automakers for localization, but more than half of them are not prepared for developing local networks in emerging markets

70%

of automakers feel well-prepared to benefit from increasing demand for used cars, but lack integrating used car initiatives with dealers

The 2015-16 study finds that those in the C-suite are optimistic about their strategic initiatives but are concerned about:

- ▶ Preparedness to respond to market volatility
- ▶ Challenges with efficiently implementing key operational and technological initiatives
- ▶ Securing resources, particularly talent

75%

of respondents cited positive impact from demand for connectivity, not focused on online/digital channels

70%

of respondents believe that innovative HR strategies to attract and retain talent will drive competitive advantage, but only 50% of them feel well-prepared

Views from across the value chain

Automaker executives



- ▶ Securing talent and deploying data management and analytics top their agenda
- ▶ Less than 20% are confident of their organizations' implementation and deployment capabilities

Auto retail executives



- ▶ Aim to strengthen data management and customer analytics capabilities
- ▶ Lack of preparedness for cost control and availability of both consumer and corporate credit

Supplier executives



- ▶ Well-prepared to tackle platform consolidation, fuel efficiency and weight reduction targets
- ▶ Concerned about executing market expansion and securing talent

Captive finance executives



- ▶ Expect regulatory environment to be challenging, but appear well-prepared
- ▶ Are challenged by securing talent and articulating effective product/service strategy

For EY's third annual automotive survey, 125 global executives were interviewed to find out what's on the C-suite's agenda for 2015-16.

"Based on our survey findings and analysis, my message to executives for the year ahead is to:

- ▶ Be prepared to respond to continued volatility, with some emerging markets facing potential recessions that could cascade to other regions and change overall sector growth
- ▶ Move faster to leverage the convergence of connectivity, mobility and IT security
- ▶ Refresh the dealer and sales experience to drive brand loyalty

- ▶ Accelerate the adoption and use of analytics and data management tools to drive operational efficiencies - from manufacturing footprint optimization to supply chain visibility
- ▶ Develop a talent agenda to secure and deliver a competitive advantage."

Randall J. Miller

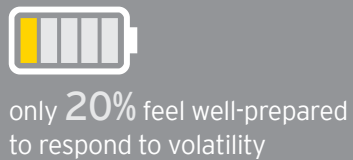
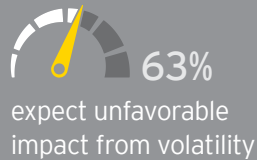
Global Automotive and Transportation Sector Leader, EY

C-suite priorities for the next 18 months

Overall impact, strategies and preparedness to execute

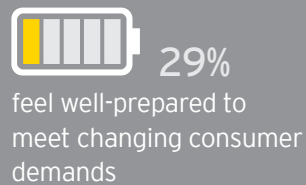
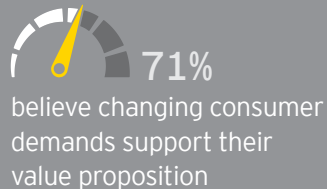
1 Navigating volatility

The automotive C-suite expects unfavorable volatility to continue, with emerging markets demand and political instability topping the list of concerns. Most feel their organizations are unprepared to respond effectively.



2 Enhancing value proposition

There is consensus across the industry on the value of features and functionality to drive loyalty, and a greater recognition of the critical role of digital in improving the customer experience.



3 Gaining competitive advantage

Market penetration/expansion, owning innovation and having an effective corporate strategy development process top the list of strategic initiatives for C-suites to drive competitive advantage.



5 Securing access to resources

While the C-suite believes critical resources offer a competitive advantage, they also see them as necessary for business continuity. Talent topped the list of critical resources, followed by infrastructure and technology. Securing these resources, however, continues to be a challenge for most of the industry.



4 Improving operational efficiency

There is a strong focus on data management and analytics initiatives to drive operational efficiency, however, few are confident in their organization's ability to execute.



1. Navigating volatility

The automotive C-suite expects unfavorable volatility to continue, with emerging markets demand and political instability topping the list of concerns. Most feel their organizations are unprepared to respond effectively.

Demand volatility - misfiring engines of growth

Slowdown in BRICS (assuming this includes South Africa), emerging markets, and concerns around Eurozone outweigh the positive outlook of the C-suite for North America.

58%

expect unfavorable demand volatility

Only 19%

feel well-prepared for demand volatility

50% of respondents selected demand from BRICS and emerging markets

56% of them cited negative impact, up from 20% a year ago

50% of them also facing headwinds from Eurozone

1/3 of suppliers identified forecasting accuracy of automakers

83% of them cited negative impact, up from 55% a year ago

Cost volatility - business as usual

Currency and raw material price fluctuations are expected to have negative impact, but considered more of an operational issue.

58%

expect unfavorable cost volatility

Only 18%

feel well-prepared for cost volatility

52% of respondents selected currency exchange rates

67% of them cited negative impact, down from 78% a year ago

34% of respondents selected raw material prices, 2/3 stated negative impact

Political, economic and regulatory volatility

Political uncertainties and product regulations around the globe are the biggest concerns, but the C-suites feel significantly under-prepared for the former.

72%

expect unfavorable political, economic and regulatory volatility

Only 25%

feel well-prepared for political, economic and regulatory volatility

43% of manufacturers selected product-related regulations

58% of them cited negative impact, while preparedness has improved

50% of automakers selected political disputes and economic sanctions

None of them are well-prepared

Market indicators

Bridging the gap – what can the C-suite do?

- ▶ Stress the need for flexibility to navigate through emerging markets, cost and political volatility.
- ▶ Achieve an optimum capacity-demand balance at a regional level as a natural hedge to exchange rate volatility.
- ▶ Focus on agility to capitalize on the upside potential of North America and China, and availability of corporate credit.

0.4%-0.5%

Annual GDP incremental increase with the \$20 decline in oil prices

46%

Share of US and China in 2014 light vehicle sales globally

50%

Depreciation of Russian ruble against the US dollar during Jan-Dec 2014

30%

Expected increase in car prices in India after implementation of mandatory safety features

19%

Standard deviation in iron ore price volatility during 2014, as compared to 11% in 2013

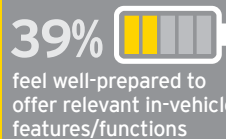
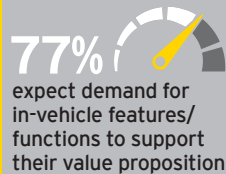
Sources: LMC Automotive, Global Light Vehicles 2014 review; Oanda.com, Historical exchange rates; Oxford Economics; Metal Bulletin, via Thomson Datastream; LMC Automotive, Global Car and Truck Forecast, 4Q14; EY analysis.

2. Enhancing value proposition

There is consensus across the industry on the value of features and functionality to drive loyalty, and a greater recognition of the critical role of digital in improving the customer experience.

In-vehicle features and functions

The C-suite believes demand for connectivity, fuel efficiency and mandated features (including driver assistance) offer the most significant opportunity to be relevant to customers.



74% of respondents selected lower emissions and higher efficiency and safety, up from 60% a year ago

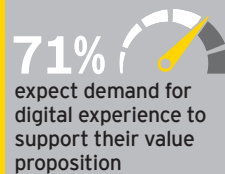
73% cited conducive impact

44% of respondents selected connectivity/infotainment and smartphone compatibility, up from 28% a year ago

Only 1 in 4 are well-prepared

Digital experience and transactions

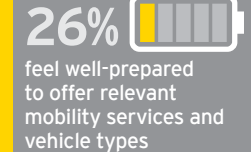
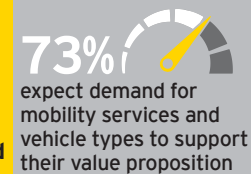
The C-suite considers delivering seamless digital/in-store experiences, and leveraging online resources to influence choice, to be critical to win and retain customers.



31% of respondents selected role of digital/online in influencing customer choices, up from only 7% a year ago

Demand evolution - mobility and vehicle types

The C-suite is divided on the benefits of incentives and competitive pricing, but strongly agree on the need to have used vehicle, corporate car sharing and fleet management solutions.



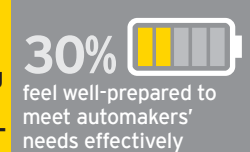
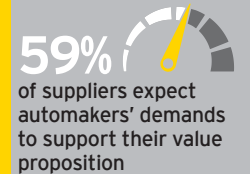
54% of respondents selected demand for new products and services including used cars, corporate car sharing, fleet management and multi-modal solutions

More than 80% cited conducive impact

2/3 of captive finance companies identified incentives and pricing, with significant majority agreeing it supported their value proposition, contrasting sharply with 65% automakers citing incentives and competitive pricing as disruptive

Demand evolution - automakers' preferences impacting suppliers

Those in the supplier C-suite believe changes in automakers' sourcing strategy is likely to be disruptive to their value proposition. However, they are more optimistic and prepared for platform consolidation, growing collaboration (among automakers) and light-weighting targets.



72% of supplier respondents selected changes in sourcing strategy of OEMs

2/3 cited disruptive impact, with less than 12% well-prepared

62% of supplier respondents selected platform consolidation by automakers

72% cited positive impact, 40% are well-prepared

Market indicators

US\$60b

Global market size for smartphone connecting technologies by 2018 (up from US\$18 billion in 2012)

72%

Of online car research sessions are multi-channel, including third-party, automaker and dealer websites

27.8m

Incremental mobile search queries as compared to desktop queries by 2016

2.3m

Worldwide car sharing membership in 2013, up from 1.8 million in 2012

Bridging the gap – what can the C-suite do?

- ▶ Align functional organizations to support the mobility and connectivity value proposition to capitalize on demand.
- ▶ Accelerate the transformation of distribution channels to give customers a seamless online and dealer store experience.

Sources: GSMA, The global association of wireless service providers; Kelsey Report, 2012; Carsharing Programs, Navigant Research; EY analysis.

3. Gaining competitive advantage

Market penetration/expansion, owning innovation and having an effective corporate strategy development process top the list of strategic initiatives for the C-suite to drive competitive advantage.

Market penetration/expansion strategies

Presence/success in new emerging markets and in regional niche segments/bodystyles continue to be a top priority on the C-suite growth agenda. For suppliers, in particular, supporting automakers' localization efforts by expanding into key markets enhances their value proposition.

67% believe market penetration/expansion strategies enhance value proposition

28% feel well-prepared to implement market penetration/expansion initiatives

49% of respondents selected presence and success in high-growth markets and segments

69% are doing it to enhance value proposition

56% of Asia-Pacific respondents are doing it to differentiate from competition

57% of suppliers selected global presence to support automakers for localization

European suppliers are better prepared, as compared to US and Asian suppliers

Product/service innovations and collaborations

Owning innovation and collaborations (within and outside the auto industry) are perceived to offer significant competitive advantage. However, business model/commercial collaboration opportunities with non-auto companies are yet to be fully exploited.

77% believe product/service innovations and collaborations enhance value proposition

26% feel well-prepared to implement product/service strategies and collaborative initiatives

42% of respondents selected technology or business model collaborations

80% suppliers selected ownership of innovation and R&D

Only **44%** of them are focused on hiring talent for innovation

45% of captive finance companies selected residual value management

Marketing and sales initiatives

Digital marketing and sales strategy are seen as critical, followed by the need to invest in customer analytics. Interestingly, innovative financing and retail strategy for alternate powertrain vehicles were at the bottom of the list.

66% believe marketing and sales initiatives enhance value proposition

26% feel well-prepared to implement key marketing and sales initiatives

39% of automakers identified leveraging online, digital and social media for marketing and sales

Only **12%** are well prepared

45% of captive finance companies selected access to intelligence and data analytics around customers

80% are doing it to differentiate from competition

Market indicators

7

Of the top 10 automakers reported a decline in share of emerging market sales during 2013-14 as compared to 2012

3rd

Rank of auto industry in patent issuance, with a 13% share behind computing and telecom
6 of the top 10 automakers are from Asia

US\$168b

Capex investments by automakers in 2014 (8% of sales), as compared to US\$159 billion in 2013

51%

Automotive executives plan to pursue acquisitions in the next 12 months (up from 29% a year ago)

40

New additions to Open Automotive Alliance in 2014, including automakers and electronics manufacturers

Sources: Financials, S&P Capital IQ; Press Room, Open Automotive Alliance; Automotive Capital Confidence Barometer, EY, October 2014; EY analysis

Bridging the gap – what can the C-suite do?

- ▶ First movers will need to make the most of a shorter window to capitalize on differentiation, whether from market/segment expansion or innovative marketing strategies, as there is consensus around strategic options being considered by peer groups.
- ▶ Establish a network of technology and business model partners within and outside the auto industry to improve agility of innovation process and focus on systematically harvesting synergies.
- ▶ Leverage marketing effectiveness monitoring and customer analytics tools to optimize digital strategies.

4. Improving operational efficiency

There is a strong focus on data management and analytics initiatives to drive operational efficiency; however, few are confident in their organizations ability to execute.

Data management and analytics initiatives

Deploying analytics tools, and using real-time intelligence around customers and the supply chain to expedite decision-making and devise new strategies, but few appear to have the ability to execute. Standardizing/optimizing IT process and technology is also a priority.

84%

believe improving profitability is the primary driver for implementing data management and analytics initiatives

Only 12%

feel well-prepared to implement data management and analytics initiatives

81% selected data management and analytics as key to improving operational efficiency

1 in 3 of respondents selected customer data analytics, down from 56% a year ago

63% of respondents selected IT and technology process/platform optimization

Suppliers are better prepared as compared to vehicle manufacturers

Manufacturing-efficiency-related initiatives

The C-suite is focused on enhancing operating efficiency of global manufacturing and enabling flexible production to adjust to changing market realities.

86%

believe improving profitability is the primary driver for implementing initiatives related to manufacturing operations

Only 16%

feel well-prepared to implement manufacturing efficiency initiatives

41% of manufacturers selected optimizing global manufacturing footprint to improve profitability

Only 1 in 6 are well-prepared

34% of manufacturers selected flexible production systems to respond swiftly to demand volatility

Only 1 in 7 are well-prepared

Supply chain initiatives

The C-suite is prioritizing optimizing low-cost country sourcing, local-sourcing in developed and emerging markets, and gaining greater visibility to ensure supply chain security.

86%

believe improving profitability is the primary driver for implementing supply chain initiatives

Only 12%

feel well-prepared to implement optimization initiatives in their supply chain

25% of manufacturers selected low-cost country sourcing to improve profitability

20% of manufacturers selected localizing supply chain in developed and emerging markets to reduce logistics costs and benefit from regional subsidies

Market indicators

21

Platforms with more than 1 million vehicles in production in 2021, as compared to 17 in 2014 and 11 in 2011

45%

Auto M&A deals will be driven by cost reduction and margin improvement, followed by improvements in supply chain

92%

Capacity utilization in the US, as compared to 50%-60% in BRICS; China's capacity utilization also dropped from 78% in 2011 to 62% in 2014

54%

Of respondents selected IT security awareness and training as a high priority for their company in the next 12 months

Bridging the gap – what can the C-suite do?

- ▶ Spearhead data management and analytics capabilities to drive agility of decision-making. This can deliver significant operational efficiencies and also reflect on financial performance.
- ▶ Flex global capacity to create a competitive advantage, especially in volatile operating scenarios.

Sources: LMC Automotive, Global Automotive Production Forecast, 4Q14; Automotive Capital Confidence Barometer, EY, October 2014; Global Information Security Survey, EY, 2014; EY analysis

5. Securing access to resources

While the C-suite believes critical resources offer a competitive advantage, they also see them as necessary for business continuity. Talent topped the list of critical resources, followed by infrastructure and technology. Securing these resources, however, continues to be a challenge for most of the industry.

Talent

The C-suite believes innovative HR practices offer competitive advantage, and consistent talent management across geographies is necessary for business continuity. In particular, they believe efforts are needed to attract, retain and nurture human capital more effectively.



Only 12% feel well-prepared to secure talent

50% of respondents selected talent for management functions (strategy, finance, marketing)

Only 1/3 of them are focusing on innovative HR strategies to attract and retain talent

46% of suppliers selected talent to drive innovation

Only 1 in 8 of them are well-prepared

Technology

The C-suite believes the need for greater connectivity and meeting fuel efficiency norms make it imperative for the industry to secure access to the requisite technologies.



Only 10% feel well-prepared to secure technology resources

38% of respondents selected the need to secure technology for connected vehicles and alternate powertrain, up from only 7% a year ago

Capital

The C-suite expects expansion across new markets/segments necessitates securing access to financing, distribution and supply chain. This is essential to reduce time to market and maintain quality, while increasing localization.



Only 26% feel well-prepared to secure capital

34% of automakers identified expanding distribution network franchised, owned

Only 1 in 4 of them selected local supplier network in emerging markets

29% of manufacturers selected financing for R&D and capex investments

Legal compliance

Establishing processes for proactive regulatory impact analysis to ensure timely interventions for minimizing financial impact, and to influence regulatory decision making is also on the C-suite agenda.



Only 32% feel well-prepared for effective compliance and reporting

34% of respondents selected compliance and regulatory reporting

Only 1 in 3 of them are well-prepared

Market indicators

US\$624b

Net financial debt in 2014, up from US\$394b in 2011 (for top 10 automakers)

50%

Increase in China's average yearly manufacturing wages during 2010-2013

53%

Organizations say lack of skilled resources is one of the main obstacles that challenges their IT security

57%

Auto executives cited high level of confidence in credit availability, up from 41% a year ago

Bridging the gap – what can the C-suite do?

- ▶ Focus on securing access to talent and ensuring compliance for business continuity.
- ▶ Extend the value chain to new industries to develop technology and infrastructure for powertrain and connectivity.
- ▶ Devise innovative strategies to retain talent and utilize infrastructure to create competitive advantage.

Sources: Financials, S&P Capital IQ; Automotive Capital Confidence Barometer, EY, October 2014; Wages in China, Trading Economics; EY analysis.

Mapping the diverse strategy preferences of the C-suite

Analysis of the C-suite responses indicates three prominent strategic imperatives, which are not mutually exclusive but need balanced representation on the boards of automotive companies.

Opportunity Seekers: focus on presence and success in high-growth geographies

These executives feel better prepared to navigate emerging markets and are confident in their product portfolio, but they may need talent for management functions.

- ▶ **1 in 2** well-prepared to navigate through volatility from BRICs/emerging markets
- ▶ **Over 80%** well-prepared to leverage demand for higher fuel efficiency, safety and lower emissions
- ▶ Only **1 in 3** focused on IT process flexibility and optimization
- ▶ Only **1 in 4** well-prepared to secure access to talent for management functions

Digital Enablers: focus on optimization and standardization of technology and IT platforms

These executives are leveraging data to drive process efficiency, business growth and supply chain visibility.

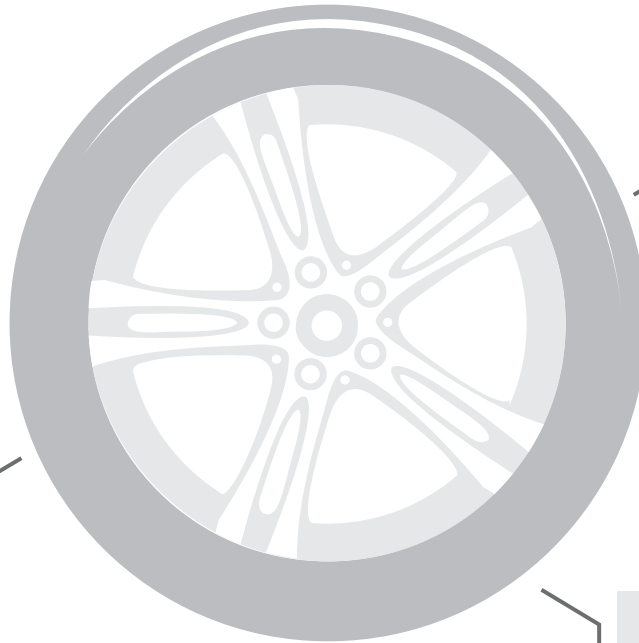
- ▶ **40%** well-prepared to drive IT flexibility in their organization
- ▶ Only **25%** well-prepared to drive customer analytics
- ▶ Only **25%** also focused on securing technology for connected vehicles
- ▶ **1 in 3** aiming to optimize global manufacturing footprint

Change Agents: driving innovation with a focus on R&D for the future

These executives are aiming to improve their preparedness on providing connectivity, leveraging digital/online sales and enabling flexibility in production and IT processes.

- ▶ **90%** well-prepared to provide features driven by regulations
- ▶ **1 in 3** favorable towards demand for connectivity
- ▶ **>20%** well-prepared to pull down silos across the organization
- ▶ **1 in 2** well-prepared to secure talent to drive innovation
- ▶ **1 in 3** devising innovative HR strategies to attract and retain talent

Key considerations for C-suite



Operating and performance

- ▶ Implement global capacity management-sharing framework
- ▶ Adopt customer life cycle approach to identify touch points to cross- and up-sell
- ▶ Leverage connectivity and captive finance to identify new revenue streams
- ▶ Focus on flexible production systems and converting fixed costs into variable costs
- ▶ Simplify processes and use technology to revamp governance, risk and compliance programs
- ▶ Embed program risk management into product development and launch processes
- ▶ Create an innovation platform to enhance collaboration within the business and with external partners
- ▶ Build analytics capabilities to positively impact customer interactions, pricing and incentive strategies, supply chain efficiencies, and other key value chain processes
- ▶ Align the organization's business and talent strategies; and elevate the emphasis placed on talent through innovative strategies to engage, reward, and empower the workforce

Investment and capital

- ▶ Integrate government incentives, direct loans and guarantees in capital raising strategies
- ▶ Assess investment opportunities and risks associated with new segments and business models
- ▶ Build flexibility into emerging markets investments
- ▶ Use need-based and strategic alliances, JVs and acquisitions to gain technology and geographic coverage
- ▶ Balance cost reduction with sustainable process change
- ▶ Benchmark leading-class performance and pursue targeted change
- ▶ Evaluate effectiveness of currency and raw material hedging strategies



Tax and regulatory

- ▶ Develop a diversified tax strategy to achieve global tax efficiency
- ▶ Incorporate international tax activities and transfer pricing procedures into the daily tax agenda
- ▶ Focus on technology and connectivity to devise new tax models
- ▶ Develop interconnected competencies and business insight to manage broad tax issues and minimize tax risks
- ▶ Align assignment and tax policies in an increasingly regulated and competitive environment

Compliance and reporting

- ▶ Introduce connected reporting to bridge internal and external reporting requirements
- ▶ Integrate data analytics to enhance compliance with corporate social media policy
- ▶ Integrate big data and advanced forensic data analytics to reduce fraud and corruption risks
- ▶ Identify relevant accounting treatment and revenue recognition
- ▶ Develop an integrity and compliance program to guide the organization's decisions and meet regulatory requirements



Want more?

Contact one of our global automotive and transportation professionals:

Randall Miller

Global Automotive and Transportation
Leader
+1 313 628 8642
randall.miller@ey.com

Mark Short

Global Automotive and Transportation
Transactions Advisory Leader
+1 313 628 8760
mark.short@ey.com

Stephane Lagut

Global Automotive and Transportation
Assurance Leader
+81 335 031 1100
SLagut@uk.ey.com

Marco Bosca

Global Automotive and Transportation
Tax Leader
+39 0115 165 236
marco.bosca@it.ey.com

Anil Valsan

Global Automotive and Transportation
Lead Analyst
+44 20 7951 6879
avalsan@uk.ey.com

Regan Grant

Global Automotive and Transportation
Marketing Leader
+1 313 628 8974
regan.grant@ey.com

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