



Press Release

Q&A with J.D. Power and Associates' John Humphrey: The Center of the Automotive Universe is Going to Change

WESTLAKE VILLAGE, Calif.: 25 March 2010 — The auto industry has undergone a major transformation during the past two years. More automakers are trying to become global at a time when some of the largest countries are struggling with their economy and worldwide new-vehicle sales are down. In addition, some of the largest automakers are facing financial and quality challenges. Where is the global auto industry headed? John Humphrey, senior vice president of global automotive operations for J.D. Power and Associates, provides an interesting perspective on the industry. Humphrey has spent more than 20 years tracking the automotive market, with half of that time spent focusing on markets in Asia Pacific and India. He recently spent nearly two years living in China, where he was immersed in one of the auto industry's fastest-growing markets.

With vehicle brands merging, being reorganized, and even sold, job cuts, plant closings and capacity issues are all vying for attention. We asked Humphrey to provide some perspective on what is happening in the global auto industry, and shed some light on the impact of it all on the industry.

Q: The auto industry is definitely as global as it has ever been and becoming even more so all the time. Can an automaker survive in this environment if it isn't global?

A: In the short run, yes, but in the long term, no. There are so many forces that have come into play in the past five years that if an automaker doesn't have the scale or the reach to compete globally, it's not going to be a viable entity.

Many automakers were sourcing a major portion of their sales and profits from developed markets like the U.S., but that's not going to be the case anymore, at least for the foreseeable future. If you look at the other markets—Japan and Western Europe, in particular—they're going to be flat, at best, post-recovery. So, manufacturers will have to be able to tap into new emerging markets to get the volumes they need.

Q: If a car company isn't big enough—doesn't have the product, the financial backing, etc.—to be a global automaker, is a joint venture or some type of partnership the way to go?

A: Automakers that don't have the size or resources to become a global manufacturer, particularly considering the changes in technology, environmental regulations, and scale requirements, won't be able to remain competitive. So the question is, how do they get the necessary backing? One solution that could make sense for some automakers is to form a strategic alliance or joint venture. There will be some brand dilution, but the real challenge is how to survive.

Q: Is there a preferable form of "marriage"? How do JVs, mergers and alliances compare, and why are some alternatives better for one maker versus another?

A: The type of deal obviously varies depending on the goals and objectives of the specific manufacturers. I think the common characteristic is that they're all very difficult, and it depends on the market. Look at the nature of the changes in the industry. The U.S. market is shrinking, which will not provide the sales and profits it did in the past to as wide a variety of players. In Japan, which was yielding profits for the Japanese, the market is not coming

back in the foreseeable future and demographics are not on their side. Western Europe is flat. Virtually everybody is looking to China, which has had a solid rate of growth. While the trend rate is still robust, profits in China for some OEMs remain elusive due to the issues related to increased competition, falling prices and overcapacity. So, if you're an automaker, you have to ask how you're going to get the size and scale to drive your organization. I don't think any one organization is in a position to take on all these changes as quickly as they'd like. So alliances and joint ventures, whether they're on product or on engine technologies, are an obvious way to go to deal with these changes.

If you look at the auto industry during the past 30 years, it's been very slow to change—it's changed at a glacial pace. But today is a new reality. There are a lot of new competitors who are very hungry. There are government pressures. There are changing consumer tastes and new markets. There are too many changes for manufacturers not to consider these options. You also have markets ripe for consolidation, like China. It's not a matter of whether that consolidation will happen, but when.

Q: Let's talk more about a specific automaker, Chrysler, which has merged with Fiat and is moving to share some of its products.

A: Chrysler is a perfect example of a company that didn't have the reach outside the United States. Fiat, bringing in the products with small-car expertise and the reach, will help them. With the costs associated with bringing new products to market, you'll see more product sharing in the future. I don't think this is a one-off situation.

Q: Have you seen any reaction by consumers who are wary of all of the globalization of the auto industry?

A: That might have been an issue 10-15 years ago, but it's less and less of an issue today. Does the owner of a German car know if their vehicle is built in South Africa or Stuttgart, and if so, does it matter?

Q: How do manufacturers manage such issues? Promote such ties, play them down, or...?

A: Clearly, they have to think about it because that's one of the biggest issues of protectionism. But the fact is that the industry is in a very difficult position, and they will have to manage this. To remain viable, a lot of the organizational strategies of these companies will have to change. It comes down to bringing the right message that is consistent with the brand image.

You can't be half-global and be successful. You have to look at how most effectively and efficiently you will need to produce your products. And if that has to happen outside your borders, eventually that's going to be the norm. There'll be reticence and political pressures, but that's where it has to go. It is an inexorable trend.

Q: The global auto industry has certainly added levels of complexity to the style, design and, ultimately, production of vehicles. What are the challenges automakers are facing in building global vehicles? And how do they find a balance to reflect unique market needs?

A: This is one of the most fundamental challenges for OEMs. They have to develop a well-differentiated product in the eyes of the consumer, and on a market-by-market basis. At the same time, keeping costs down and reducing complexity becomes an imperative. Unfortunately, those two items are difficult, countervailing challenges. And often what we see winning out is the near-term drive to cut costs rather than meeting the target consumer's product needs. You wind up missing the market and relying on subvention.

I just don't think we're at the point where you can do a bang-up job on a global car, but it's more likely on a regional basis. However, the globalization of consumer tastes and increases in flexible manufacturing will assist in making this more of a reality in terms of execution.

Q: Some automakers, such as Toyota, among others, are giving more, rather than less, flexibility to individual markets and their ability to change global products. Let's discuss part of it.

A: We see this as an increasing trend. We see a lot of automakers letting their local R&D hubs have more input into the design of a vehicle. Many OEMs would design for their home or volume markets, so there might be minor changes, whatever needed to be homologated for regulatory issues, but in terms of consumer changes, local demands became a subordinated priority. Now we're seeing more makers draw on local market needs, in terms of the input. Whether that input is listened to depends on the maker, but you'll see more and more of this.

There are cost implications. Instead of a few large markets, we see an increasing number of emerging markets where a degree of local customer needs must be addressed.

This is one of the differences we see now that could lend to the success of global products. Leveraging global platforms with local design elements could be considered the only way to have cost containment and satisfy the local market's consumers.

Q: What are the challenges of unique regional regulatory emissions issues in light of global vehicles?

A: Part of the equation is what consumers want. If you don't build to meet customer expectations, you don't have a business case. The other side is emissions and other regulations. Over time, you'll see them converge, but for now, there's a lack of uniformity. And, as the markets fragment, you have to go after different markets, and this is where you have big differences. Europe is more diesel-based, Brazil more ethanol. The U.S. is focused on gasoline. And then there are the pressures for various electric propulsion systems. Who can do all of that in a cost efficient manner?

Q: Has building global vehicles created quality and reliability challenges? For example, European consumers generally don't see a need for cupholders in their vehicles. Yet, Americans see them as a necessity, and when they don't have them—or don't have enough of them—they see that as a quality problem or a design defect.

A: Once you communize things, you do run the risk of creating what you might call the "soft quality" issues, but not so much reliability problems. As good as quality levels have become in the U.S., the gaps are a lot bigger in other markets we measure.

The key will be to find the efficient common base and add flexibility into the process to allow for individual market differences.

Q: Have automakers had to change their metrics—the way they measure quality, vehicle design or customer satisfaction—because of the global nature of the industry? Or do they still measure it one market at a time?

A: The industry, overall, has become more uniform in how it measures customer satisfaction. What they're still working on is trying to understand the hot buttons in individual markets. You may see a greater frequency of customer concerns in one market than in another.

Q: J.D. Power has said the U.S. auto industry needs to work its way out of the current industry downturn one vehicle launch at a time. Can the same be applied to the global market, which in the majority of markets is experiencing the same struggles as the U.S. market?

A: Absolutely. We've seen manufacturers come out with products that just don't meet the needs of that target segment. You have a bad launch and not only do you have to live with the financial consequences of that product, you also have to live with the impact on the image of the brand. The margin of error is very small in today's competitive environment. We've seen, in a lot of emerging markets, launches that show automakers don't understand the needs of the market and the product is a dud. And, unfortunately, that still happens in the U.S.

There's still a lot of learning that needs to be done in the emerging markets. And, in the long term, that's going to have a big impact on the health of a manufacturer.

Q: From the J.D. Power perspective, what does the global auto industry look like in five or 10 years?

A: Ten years down the road, the auto industry will be extremely different from the way we know it now. We're forecasting about 67 million units being sold this year, down from 70 million in 2007. We see surpassing the previous peak of 70 million by 2011, to 72 million units, so the market on the surface will be back to normal. However, that's as far as you can get from the truth, because you're going to have a very tough situation in the U.S and other mature markets.

The U.S. is not going to be the dominant powerhouse it was. The years of 16- and 17-million-unit sales were artificially created, with incentives and fleet sales to rental car companies. We do forecast that it will return to that level eventually, but not for several years, and more because of increasing numbers of households and vehicle replacement demand. Western Europe will still have its struggles and won't come back until 2013 or 2014, as scrappage incentives pulled sales into 2009. Manufacturers will have to look to the emerging markets for growth, and they're not only smaller, but more difficult. You hear about China growing at a compound annual rate of 22 percent a year during the past five years, but it is a highly competitive market, with more manufacturers competing there than in any other market in the world. Despite the growth in China, profits have been elusive for a lot of manufacturers and lack of flexible capacity could be an issue.

Manufacturers will have to be adroit at exploiting more markets than before, and the question is, how are they going to do that? Can they get the scale needed to make a profit? There's a lot of talk about world cars, but we foresee the need for regional products, consistent with global development. There's going to be a need for consolidation. We see more alliances and joint ventures—a lot of manufacturers don't have the financial or technical wherewithal to meet the needs, considering all the demands for new technology, so they're going to have to strategically identify people to partner with.

The auto industry used to be the U.S., Japan and Western Europe. They'll continue to be important, but they'll continue to decrease in terms of their contribution to the profitability of the OEMs. That, in and of itself, will force more manufacturers to go global. Add in all the regulatory requirements, and manufacturers will have to become more flexible. The center of the automotive universe is going to change.

Q: What role will electric vehicles play in the global auto market?

A: It may lead to a profound change, but that is likely at least a few years out, in reality. There will be a couple of players that come out and drive that shift. As battery technology becomes more financially feasible, that's a game-changer. If you look back 10 years, there wasn't much talk or much advancement in terms of alternative power. Now you have diesel, hybrids and ethanol all in play, so the traditional petrol automobile is going to be challenged along with the rest of the industry. That being said, we expect petrol vehicles to continue to dominate overall global share by retaining more than 68 percent of overall global volume by 2015. If you consider oil a finite resource—or at least a commodity that has the potential to be more volatile in terms of supply—that will create a greater sense of urgency in all of these developments.

Q: Are all of these changes we're seeing in the global auto market a surprise?

A: I think the auto industry was ripe for change for a long time, but there were a lot of factors pressing to maintain the status quo. Now, I think the financial crisis and regulation is going to be the impetus of a lot of change we'll see play out over the next 10 years. If it didn't happen, the industry might have limped along for the next decade, but the depth and severity of the crisis will be the catalyst for substantial change over the next 10 years.

The U.S. market is unique from any other market. But the growth we're projecting in emerging markets is in the A and B segments, which are pretty much non-existent in North America. So, the challenge for the Detroit Three is to get to the point where they can make money on small cars, which they haven't been able to do in the past. The emerging markets offer a huge opportunity in terms of volume, but looking at the mix, it's going to be a tough road.

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