The Impact of the Single European Market on the Asian Car Makers

The emergence of the Single European Market as a result of economic integration of Western European nations became official on 1 January 1993. Part of the “EC92” effort includes the initiative to remove technical and trade barriers amongst the 15 member countries. This economic integration will no doubt have serious implications on global trade.

It is the intent of this paper to make a *provisional* analysis and discuss the implications and effects of the integration on Asian car manufacturers seeking to establish themselves in the European new car market. The first part of this paper will establish the foundation for subsequent discussions by introducing the effects of integration and their impact on the European car market and its automotive industry as a whole.

The second part examines the advantages and disadvantages in light of the characteristics of the SEM that a new entrant may face in the 1990s and consequently discuss what strategies the Asian manufacturer will need to consider in order to establish production facilities in the EU. Correspondingly, market entry options and political strategies with their home government must be carefully thought of as they are the other critical success factor in the penetration of this highly competitive market.

The Single European Market

To the rest of the world, the European Union represents a huge market for their products and services with the population of 372 million (1995) that far exceeds the US and Japan population of 263 and 125 million respectively. In addition, the population have the willingness and the ability to purchase. For the car market, it is essential that the population posses that buying power as a car is regarded as the second most substantial investment in one’s life, the other being a house, that is what makes the Western European market attractive to Asian car manufacturers compared to say, South America. Western Europe has the largest car market in the world with annual sales between 10 to 14 million vehicles (1988-1993), that represents approximately 39% of the world car sales. It is also a highly competitive industry with 6 major players (Ford, General Motors, Volkswagen, Fiat, Renault, PSA Peugeot-Citroen) with none of them being dominant player.

In recent years, Japanese car companies have a chalked up a combined 12% (1992) of the total EU market share, which is worth 1.56 million vehicles. Despite their late entry into the European car market (compared to GM and Ford), the Japanese car manufacturers have managed to establish themselves as one of the most formidable challengers in a relatively short span of time, to the extent that this success has been viewed as a threat not just by the 6 major players, but also by certain host governments as a threat to their national industry (such as France). This apparent success by the Japanese in penetrating fortress Europe has spurred the interest of other Asian car manufacturers to attempt the same. Compounded by the promise of further economic integration, the market potential of the emerging Eastern European countries, the Asian car maker's presence in Europe is indeed very strategic.

There are also distinct features of the EU itself that makes it an attractive for the Asian car manufacturers to set up their operations within the EU. Besides proximity to market, the move will have strategic advantages in terms of trade and competition with the European counterparts. Therefore, locating themselves in Europe is a critical success factor for the Asian car manufacturer who wish to achieve long term cost reduction with economies of scale and increase product variety to strengthen their international competitiveness.

To fully understand the implications of the SEM, we need to examine the key principles behind the SEM. The SEM can be perceived as the common market (CM) stage in the process of economic integration (Vickermann 1992) where a common external tariff (CET) exists, tariff and non tariff barriers are removed and there is factor mobility.

CET, Tariff and Non Tariff Barriers

Today, a car manufacturer may export their products as completely built up units (CBU) to the EU but it will attract 10 to 22% import tariff that will make their products not competitive compared to the cheaper European manufactured cars. In a market where price differential is an important win factor, car manufacturers who wish to establish themselves in the long term must set up the manufacturing plant within the EU just to remain competitive. The establishment of production plants within the EU will not only eliminate the CET and the tariff barriers but alleviate some of the non tariff barriers as well, a result protectionist sentiments. This is evident when Nissan founded Nissan Motor Manufacturing, U.K., Ltd. to make passenger cars in the United Kingdom, and by raising the local content to 80%, the U.K. government authorized Nissan's products as a U.K. made, allowing Nissan to export them to the French market.

Factor Mobility

Another virtue of the SEM, is none other than the factor mobility. The factor mobility principle means freedom of movement of goods, capital, services and people, which means enormous cost savings to the industry as a whole and efficient access to the entire EU market. Specialization as a consequence of factor mobility imply that the entire industry from many existing locations to concentrate in a smaller number of preferred locations, thereby reducing the duplication of facilities by the in other EU nations..

The Asian car manufacturers from Korea and Malaysia may find this to be an advantage compared to manufacturing within their home countries. With the limited size of their home and regional markets, they cannot, in the short time frame, achieve the economies of scale at the industry level. The Western Europe car manufacturers enjoy these regional advantages that the SEM offers, something that cannot be found elsewhere in the world. The realization of the "ASEAN Single Market" is still very distant in the future.

Given that almost 70% of a car is produced by the car component industry (Freyssenet & Lung 1996), the need of price competitive component suppliers is just as important.

The new entrants may take advantage of the existing components industry as a source of supply through intra industry trade.

Factor mobility also offers the flexibility of location or rather relocation. Although studies have shown that labour cost is only a fraction of the value to the car (7 to 10%), manufacturers are keen to limit the growth of direct and indirect wages paid to workers and social benefit institutions to avoid cost inflation. The flexibility to relocate the plant allows the manufacturers to take advantage of the cheaper labour. The availability of cheaper labour in Spain has led to the relocation of production operations from the UK in 70s. Today, the same pressure to relocate to Eastern Europe is threatening Spain.

The need to harmonize technical specifications and standards, where mutual recognition of these standards by their member states are key to the success the SEM. Perhaps the most significant factor of the SEM to the automotive industry is the elimination of national type approval for vehicles by establishing one set of rules for vehicles and their parts throughout the EU. This became a reality in March 1992 for passenger cars and in June 1992, the EU member state officials approved the adoption of EU legislation for creating a single system for certifying the passenger cars for safety and other technical requirements. This directive means that the manufacturers will only have to get one approval done and they are able to market their products to the rest of the EU. This not only represents a significant cost savings to the producers but also a removal of another form of non tariff barrier. They are then able to ship and market their products with minimum delays. The resultant cost savings will further enhance price competitiveness, cost leadership, product development and the time to market of their products. Therefore by operating within the EU, it will at least help reduce the relative disadvantages of the Asian manufacturers as “outsiders”.

With the same token, this factor also mean the ability to access the entire European car market, its distribution channels and customers. At the same time that it introduces and increases the competition amongst the car makers. This in turn forces the manufacturers to be extremely efficient in order to survive. Most of the major players have already adopted if not in the process of implementing lean production and lean distribution to remain competitive. The same competitive pressures have forced many archrivals to form joint ventures or joint product development and research, like Honda and Rover. Asian companies must be willing and able to form effective joint ventures that will help them reduce their cost of production.

For the Asian car manufacturers, there are also disadvantages in setting up operations in the EU. Although the SEM is official but the process of removing non-tariff barriers is still on going. The French and the Italians for example, wish to protect their national champions which fare well under protected markets. To them, their car industry is not just a part of their national identity but a significant contributor to their country's GDP. Fiat for example contributes 4 percent to Italy's GDP, therefore their home markets are very fiercely guarded territories therefore the penetration of the Japanese car makers into these countries are still very limited. Furthermore, the southern European car makers like Fiat, Peugeot and Renault are very influential in the automotive industry related policy making in their respective countries. Accordingly, any head on competition with them may result in regulations that are detrimental to the Asian car manufacturer.

The unavailability of distribution channels is also a major disadvantage to new entrants, the painstaking establishment of a distribution network may be very costly in the initial stages. One alternative is to develop partnerships with multi-franchising dealers, another is through the acquisition of the dealers. Some other manufacturers have adopted the concept of manufacturer owned dealership. Korean car maker Daewoo has been quite successful in the UK since its launch in 1995 by applying the establishing a manufacturer owned dealership. Similarly, the availability of an efficient supply chain is a prerequisite to lean production and therefore cost leadership. The establishing of an efficient supply chain is also another form of barrier to entry. Asian companies must be prepared to take losses in the initial stages of operations within the EU.

Cultural and language differences are yet another set of challenge for Asian car manufacturers. The unfamiliarity with local culture may lead to management and communication problems which may lead to delays of all sorts. In addition, the existence of national sentiments, preferences or perceptions of inferior quality of the Asian products may exists and can be a drawback in for the Asian car maker.

The competitive pressures to implement true lean production and distribution is enormous for the new entrants. Proton of Malaysia for example, have operated within its home country under the protection of high tariffs on both imported and locally assembled vehicles. Without the competitive pressures as intense as that to within the EU, the need and hence the motivation to be truly lean will limit the availability of skills, know how and technological advantage to implement a lean production in the EU.

Market Entry Options and Political Strategies

There definitely no single “best” market entry strategy in this case, it really depends on a variety of factors, but all of these factors require the Asian car manufacturers to commit to the long term presence which will not be immediately profitable.

The selection market entry options depends on the intent and market strategy of the company. Factors such as speed of market entry, costs (direct and indirect), risks (political, competitive, financial), investment payback period, long term profit objectives need to be considered.

The most obvious mode of entry is to emulate the Japanese transplant operations which has proven to be very successful in UK during the early 1990s. This move can be classified as the greenfield strategy. The greenfield strategy involves starting a new operation from scratch. Nissan’s factory in Sunderland UK is an example. This strategy allows the firm to start anew without having to deal with existing debts, aging equipment and many other that an existing plant faces. It also means an opportunity to implement new technologies and techniques such as Japanese style lean production with minimal resistance. Furthermore, by locating the plant in the host country will provide the locals with employment opportunities and boost the local economy. However, this strategy takes time and effort to bear fruit and the companies may have to endure initial losses before realizing any profit. Moreover, there is pressure to increase local content to a certain level within an agreed time frame with the host government. The ability to achieve the desired local content is a critical to the ability to access EU market. Typical strategy to overcome this difficulty is through the acquisition of strategic component suppliers or smaller players with certain technology and resources. It is widely believed that Proton's recent acquisition of a 80% stake in Lotus Group International Ltd., a well know automotive engineering company and manufacturer of luxury sports cars, is to gain access to advanced engine technology which the Japanese did not offer. Also, as mentioned previously, "coopetition" (cooperate and compete) type joint ventures amongst manufacturers and component suppliers alike is becoming a trend where archrivals have joint ventures ranging from product research and development to the sharing of principal common components in an effort to reduce their production costs.

The Asian car markers can also enlist the help of their home governments to guard their interests against adverse EU regulations, unfair competition or to negotiate a favorable market entry condition with the host country government.. Like the U.S. companies, the Asian companies can persuade their home governments to set up and maintain a permanent mission to the European Union. Similarly, the Asians can also enlist the help of EU member state representative to lobby for them on the premise of job creation. Home governments may also set up bilateral trade agreements that will progressively open up the markets of both nations, thereby providing the opportunity to penetrate the EU market. On the larger scale, their may increase their bargaining power by lobbying for their regional trade bloc to negotiate directly with the EU for better agreements. The Asia Europe Meeting (ASEM) in March 1996, brought together ASEAN countries, with China, Japan and South Korea with the EU members to enhance economic ties through political dialogue to increase trade and technological transfer. This may serve as an avenue for the Asian governments liberalize trade between the two regional trade blocs. The World Trade Organization is another channel for the Asian car makers and their governments to seek multilateral trade agreements as well as dispute settlements of unfair competition or trade policies.

Conclusion

The car industry as a whole in not new to international competition. The need to diversify into other markets will be a key determinant of the long term viability of any car maker in the 1990s. The SEM is matured and saturated market with stiff competition for limited demand, therefore the competitive risks are relatively higher compared to other regions. Asian car manufacturers like Proton, while being a serious player in the EU car market (the U.K. being its largest overseas market by far) have diversified its sales and operations to as many as 25 other countries. This is essentially to safeguard the company against any regional economic downturns and at the same time to exploit other emerging markets. Despite the stiff competition, Asian car makers will continue their attempt to gain entry into the European market in order to exploit the availability of advanced automotive technologies and future European markets.

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