

Surviving in CEE

Global financial crisis makes region's automotive sector leaner and meaner

Bratislava, 14 January 2009 - The world is not coming to an end – at least not for manufacturers in the auto sector in Central and Eastern Europe (CEE). So says Tom McDaniel author of KPMG's new report "Benchmarking the Auto Industry in CEE". Despite the US auto industry facing potential bankruptcy and receiving a bailout from the government, in CEE enterprises in the auto sector will find ways to tighten their belts and prepare for the future.

"The Big 3 – General Motors, Chrysler and Ford - are facing bankruptcy and a shrinking of the economy, but this is not necessarily the case in CEE," explains McDaniel. "Suffering here in many countries is a reduction in economic growth – the auto sector will be hit the hardest, but these enterprises have had some good years and will have re-tooled. So while there may be total shutdowns in production elsewhere, in some of the stronger performing factories in the region they may shutdown just a shift. In other cases it could be worse, of course."

He adds "It will be a tough time, but it's not necessarily comparable to the US."

The KPMG Survey queried 25 auto component manufacturers within Central and Eastern Europe and used information from KPMG's global Automotive practice to serve as a basis for comparison to benchmark business practices within the region.

The CEE Benchmarking Survey looks at factors like how to help enterprises create and preserve value, manage risk and increase profitability margins. "It's a tricky thing to do all that at the same time," says McDaniel. "You must have balance. Outsized profits can come through the ignoring of risks, so we try to touch on all aspects."

The auto sector in CEE, until recently, has been extremely dynamic and an engine of growth and value, according to McDaniel.

"Well established manufacturers have been following vehicle makers to Central Europe where they have great proximity to markets and materials and an excellent workforce who provides great value – not only are costs less, but the workforce is very productive, and the environment is very good in comparison with the West, which is highly unionized."

McDaniel explains that countries like the Czech Republic and Slovakia are traditionally well known for their manufacturing activities. Poland, Hungary and Romania are less industrial, but did

manufacture trucks and busses, respectively, during communist times. Romania, meanwhile, benefits from the same dynamics and, from an affordable labour standpoint, is sometimes referred to as the “China” of Central & Eastern Europe. He says all of these countries have been generating lots of investments in the automotive sector.

While it is not immune to the effects of the global downturn, it may offer manufacturers in the sector opportunities for making their operations more efficient.

“If consumers can’t get loans, that affects demand. But the financial crisis may separate the wheat from the chaff,” McDaniel explains. “Even those suppliers who have always been lean have mentioned labour costs and inventory as two of their top three concerns, a sign that they’re increasingly concerned about cash conservation and cost control.”

In terms of labour McDaniel says that manufacturers report different strategies concerning their workforce depending upon their financial state. “The good ones can keep their workforces on board, while the others let employees go, so they’re not just cutting fat but meat.”

Retention of high quality labour is also a major risk, according to the CEE Auto Industry Survey participants.

“That is a constant story we hear. Companies are having a hard time meeting labour demands and sometimes have to go outside their own countries and bus in workers,” says McDaniel. “So in an environment where you have pressure to let their workers go, some of these companies are getting themselves into a vicious circle because they’ll be unable to hire good quality workers when good times come back.”

He says that’s why it’s so important to have a lean workforce, because manufacturers just can’t afford cheap labour - good quality labour is more productive and ultimately cheaper.

In such tumultuous economic times McDaniel says it’s important for these enterprises to look at their inventory levels and cash flow. The price of cash in this environment is very expensive, he says, and mentions that about half of participants in the KPMG survey said that their inventories were too high.

Inflation has also proven to be a top-of-mind risk issue among auto industry firms in CEE, and responses from the KPMG survey participants bear this out. “What distinguishes our region,” says McDaniel “is that it’s a more dynamic environment and has had faster growth, which makes for greater volatility and faster inflation.”

He points to the vast strengthening of currencies in countries like the Czech Republic and Slovakia to bolster his point. “Both countries’ currencies have strengthened immensely, which can be a killer if you’re a components supplier, because typically your customers pay in euros, while your costs are in the local currency. So if your currency appreciates 10-15 per cent, your costs are going up in an industry whose margins are 2-5 per cent. This can result in losses.”

Ľuboš Vančo, managing partner in KPMG in Slovakia: “Generally speaking, with the adoption of the Euro currency in Slovakia this will no longer be an issue. However, it will remain visible at least in the financial statements for 2008 and 2009 when companies will be realizing lower revenues.”

McDaniel adds that some suppliers in CEE said they'd had to completely change their financial plan three-quarters of the way into the year because the strength of their local currency wrecked their original forecasts.

Administration at firms in CEE is also a key risk area, according to McDaniel: legislation is constantly changing, oftentimes contradictory, and manufacturers in CEE say they don't have the resources to address such regulatory issues. That's why for specific issues like tax compliance, enterprises that employ a consistent, more "holistic" approach can do a better job of managing their tax obligations, not paying more than they have to.

"What we at KPMG have experienced," explains McDaniel, "is that having a more holistic approach tends to save you money, and in an environment like this, saving money is critical."

McDaniel says that KPMG professionals are able to assist auto sector firms in CEE to address their burning issues, like helping them analyse processes to reduce inventory levels while maintaining high levels of customer service. By facilitating access to key customer information, KPMG can also support better cash management for manufacturers.

-Ends-

About KPMG

KPMG is a global network of professional firms providing Audit, Tax and Advisory services. We operate in 140 countries and have 123,000 people working in member firms around the world. The independent member firms of the KPMG network are affiliated with KPMG International, a Swiss cooperative. Each KPMG firm is a legally distinct and separate entity and describes itself as such.

Press contacts:

KPMG Slovensko spol. s r.o.

Zuzana Balážová

Marketing & Communications

+421 908 745 512

zbalazova@kpmg.sk

Media In – public relations agency

Zuzana Lacová

Managing Partner

+421 911 229 399

zuzana.lacova@cohnwolfe.sk