

Case study: automobile industry in russia



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Introduction

The automotive industry designs, develops, manufactures, markets, and sells the world's motor vehicles. In 2008, more than 70 million motor vehicles, including cars and commercial vehicles were produced worldwide.

This paper is focused on the global automobile industry its economic potentials, trends, economic impact, and its implication to the business world. Moreover, the case study will analyze the case of Russia. This country is considered as one of the world's superpowers alongside with the United States from year 1945 until its break – up in 1991. Russia is one of the fifteen union republics who belongs to the Union of Soviet Socialist Republics (USSR) or commonly known as the Soviet Union. It was a model state governed only by the Communist Party.

Russia was the largest Republic of the former Soviet Union but it was dissolved in 1991. It was liberated from the Union and has been liberalizing ever since then. Russia's economy has withstood a transition from ' Shock Therapy' to ' Consumerism'. Income levels have been rising and economy has been growing.

In 2007, a total of 71. 9 million new automobiles were sold worldwide: 22. 9 million in Europe, 21. 4 million in Asia-Pacific, 19. 4 million in USA and Canada, 4. 4 million in Latin America, 2. 4 million in the Middle East and 1. 4 million in Africa. The markets in North America and Japan were stagnant, while those in South America and other parts of Asia grew strongly. Of the

major markets, Russia, Brazil, India and China saw the most rapid growth (www.wikipedia.com/automotiveindustry)

About 250 million vehicles are in use in the United States. Around the world, there were about 806 million cars and light trucks on the road in 2007; they burn over 260 billion gallons of gasoline and diesel fuel yearly. The numbers are increasing rapidly, especially in China and India. In the opinion of some, urban transport systems based around the car have proved unsustainable, consuming excessive energy, affecting the health of populations, and delivering a declining level of service despite increasing investments. Many of these negative impacts fall disproportionately on those social groups who are also least likely to own and drive cars. The sustainable transport movement focuses on solutions to these problems.

The automobile industry of Russia faces several challenges ever since. But, it never stops from an adventurous journey until it became a hub for a world – class service and earns a brand loyalty as well. Based on the study, the automotive market is one of the most dynamic sectors of the Russian economy. It has increased in value by 27% over the last three years and it is expected to increase all the more. A projection growth of local production of foreign brands to increase by as much as 375% in the next seven years (A PricewaterhouseCoopers Study).

Also one of the prominent car manufacturers in Russia is AvtoVAZ a Russian car manufacturer in Togliatti, Samara Oblast. All AvtoVAZ vehicles sold currently are of the Lada brand but this has not always been so. Ladas were AvtoVAZ's export vehicles, the same models being sold under the Zhiguli

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brand on the domestic Soviet market since 1970. They became extremely popular during later decades in Russia and Eastern Europe, particularly the former Soviet bloc countries where they have become a symbol of city life. From cities like Prague to Astana, Kazakhstan Lada cars are a very common automobile on the urban landscape.

Lada made its name in Western Europe selling the Fiat 124-based VAZ-2101 and its many derivatives as an economy car in large quantities during the 1980s, but subsequent models have not enjoyed the same success.

Being exported worldwide in the 1980s and '90s, the Lada was a big earner of foreign hard currency for the hard pressed Soviet economy, and was also used in barter arrangements in some countries. Over 3/5ths of Lada production was exported, mainly to western countries (the US was the only large market not to have imported Ladas) and Lada is unique in being the only car brand found on every continent of the world, including Antarctica (where the Russian research base used Lada Nivas). The rugged design of the Lada Classic, built with heavier gauge steel bodywork, to cope with extreme Siberian climates, poor roads and few service facilities in many parts of Siberia, meant that high mileages (300, 000 mls [480, 000km]) were possible under less extreme operating conditions. Because of their very competitive pricing and ease of service, Ladas are common as police cars, taxis, and a range of public service/civil defence vehicles in many parts of Europe, Africa, and the Caribbean.

In March 2008, Renault purchased a 25% stake in AvtoVAZ in a \$US1 billion deal. This is expected to result in new Lada models being developed on

existing Russian assembly lines and increased output. The remaining 75% of AutoVAZ continues to be owned by the Russian state owned Rostekhnologia corporation. Lada is now part of the Renault-Nissan-Lada group, which is the world's third largest automotive group (after General Motors and Toyota) In spite of a flood of western models into the Russian market in recent years, Lada has managed to maintain fairly constant sales figures.(<http://en.wikipedia.org/wiki/Lada>)

The Trends in the Global Automobile Industry: An Explanation

The industry is facing an increase in external competition from the public transport sector, as consumers re-evaluate their private vehicle usage. Roughly half of the US's fifty-one light vehicle plants are projected to permanently close in the coming years, with the loss of another 200, 000 jobs in the sector, on top of the 560, 000 jobs lost this decade. Combined with robust growth in China, in 2009, this resulted in China becoming the largest automobile market in the world.

The top three countries namely: Japan, People's Republic of China and United States of America are considered the leading countries in vehicle production. The top three motor vehicle manufacturing companies by volume 2008 are the following: Toyota, General Motors and Volkswagen. The International Organization of Motor Vehicle Manufacturers (OICA) identified vthe top three in the list: Toyota Motor Corporation - Japan, General Motors Company - United States of America, Porsche Automobil Holding SE - Germany(<http://oica.net/category/production-statistics/>)

One of the most promising business venture is the world is the automobile industry. It has a great effect not only the economy but also the multi cultural significance of the world. It provides jobs for millions of people, generates billions of dollars in worldwide revenues, and provides the basis for a multitude of related service and support industries. Automobiles revolutionized transportation in the 20th century, changing forever the way people live, travel, and do business. The automobile business is evolving rapidly on a worldwide basis. Car and parts manufacturers are merging, component design and manufacture are now frequently outsourced instead of being created in-house, brands are changing and the giant automobile companies are expanding deeper into providing financial services to car buyers. Meanwhile, all of the biggest, most successful automobile industry firms have become totally global in nature. Globalization is in evidence throughout the automobile industry.

The following are considered the major firms of the Automobile Industry:

General Motors Corporation - Employing a whopping 335, 000 people, GM is the largest vehicle manufacturer in the world. It is headquartered in Detroit, Michigan, but it has operations in roughly 55 countries outside the U. S. and Canada. GM owns other manufacturers, including Chevrolet, Pontiac, and Hummer. A very diversified company, DaimlerChrysler produces everything from sports cars to utility trucks. It is headquartered in Stuttgart, Germany, and primarily operates in the U. S. and Western Europe. Toyota is the epitome of a worldwide company, selling vehicles in more than 170 countries and regions. It is headquartered in Toyota City, Japan, and employs approximately 285, 980 people. Ford's brands include Lincoln, Mercury,

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Jaguar, and Volvo. The company manufactures and distributes automobiles across six continents. It primarily operates in the U. S. and Europe, and it is headquartered in Dearborn,

Michigan. “ Big Three” – GM, Ford, and Chrysler – are world leaders in revenue, they fall significantly behind the Japanese manufacturers in terms of net income (2008 Global Market Data Book”, Automotive News, p. 5)

As mentioned before, the “ Big Three” U. S. automakers are losing significant market share to foreign producers. Two main reasons for this are higher costs and an increased consumer demand for luxury. As the prices of oil and other raw materials have gone up, so have production costs. While automakers from all countries are faced with these challenges, only U. S. firms have to deal with labor unions. Employee benefit costs, especially those related to healthcare, have been rising sharply over the past few years. For example, between 1999 and 2005, GM’s non-pension retirement benefits (mostly healthcare) rose at a compound annual rate of 10. 6%. Automakers must also tackle consumer demand for better safety and electronics features. Customers want side airbags, antilock brakes, and electronic stability programs (ESP), which apply pressure on each wheel to prevent drivers from losing control of their cars. Other trends in electronics include higher demand for global positioning systems (GPS) and premium sound systems (Plunkett Research, “ Automobile Industry Introduction” 2008).

Another threatening trend to U. S. automakers is the increased foreign presence in the full-size pickup truck market. Vehicles such as the Toyota

Tundra and the Nissan Titan are becoming more and more popular with American consumers. However, for the immediate future, it appears that the Big Three will continue to dominate this market, as they captured 91.4% of the market share in 2005.

In 1998 European firms were producing nearly twice as many vehicles as their US counterparts and about a quarter of the total production of the American. In return, North American firms were only responsible for about 20% of the total production in Europe. Furthermore, Japanese firms, at the time representative of all of Asia, were also producing more vehicles than the US and were responsible for about 20% of America's production; US firms on the other hand produced nothing in Japan and negligible amounts in Asia. In 2005, Asia became the largest producer of passenger vehicles with Japan out producing the next two top producers - Germany and North America(http://www.euro.who.int/transport/hia/20021009_2. Retrieved 2008-08-29)

As a result, foreign companies are forced to set up manufacturing plants in the large market countries in order to reach the consumers. For example, Toyota - a Japanese motor company - has 14 factories in the U. S. that accounts for nearly half of its total vehicle production destined for the U. S. market. This in turn has ended up strengthening the foreign firms and discouraged the build up of competitive advantages from the US firms. In 2007, a total of 71.9 million new automobiles were sold worldwide: 22.9 million in Europe, 21.4 million in Asia-Pacific, 19.4 million in USA and Canada, 4.4 million in Latin America, 2.4 million in the Middle East and 1.4 million in Africa. The markets in North America and Japan were stagnant, <https://assignbuster.com/case-study-automobile-industry-in-russia/>

while those in South America and other parts of Asia grew strongly. Of the major markets,

Russia, Brazil, India and China saw the most rapid growth. In 2008, with rapidly rising oil prices, industries such as the automotive industry, are experiencing a combination of pricing pressures from raw material costs and changes in consumer buying habits(OICA. <http://oica.net/wp-content/uploads/world-ranking-2008.pdf>)

From Command to Market Economy

The Soviet Union was considered a greatest socialist state from 1922 to 1991. It is also considered as the world's superpowers comparable with the United States. In the year 1956, it grew into 15 union republics governed by a Communist party and became then a model state. After a dissolution of the Soviet Union, the 15 union republics became independent.

Out of fifteen, eleven of them aligned to form a loose confederation known as Commonwealth of Independent States (CIS). Russia by then became an independent country and an influential member of the CIS and became the Soviet Union's successor in diplomatic matters.

After the dissolution, Russia lifted price controls on 90 % and 80% for intermediate goods. By the end of 1992, the budget deficit was 20% of the Gross Domestic Product much higher than 5 % projection.

After the disintegration of the USSR, crisis on Russian economy was felt. It took the responsibility of settling USSR's external debts. The petroleum,

metallurgy and some other state enterprise was privatized for a sum of US \$ 600 million and the population plunged into poverty.

The government controls money and credit emissions in three ways. One, allow the central bank to increase interest rates on credits by issuing government bonds. Second, partially financing budget deficits and Third, close inefficient state enterprise. In 1994, stability on finances was officiated by the Central Bank as it issued credits to enterprise at subsidized rates. In 1995, the government maintained its commitment to tight fiscal constraints. Pressure started to mount on the government. In this particular year, the state failed to address many obligations as well as the wages of most state workers. Revenue shortages were blamed on number of factors, but by 1996, Russian enterprises and regional authorities had established a strong pattern of non - compliance with tax regulations and police service was not able to nab violators.

In August 1998, Russia plunged again to financial crises and inflation shot up by 84. 5%. These negative impact to Russia affected its external balances and public finances as well. Russia became especially prone to external shocks caused by cyclical fluctuations in the world market prices and a great demand for primary commodities. In the same year, lack of progress in coping with budget deficit led to

IMF tension. Investors too are anxious about the aftermath of Asian crisis.

Another setback for Russia during that time is the failure of Tokobank.

Investors started to pull out the Russian GKO. The government failed to auction 75 % stake in the oil giant Rosneft. Russia's strategy to profit from

the favourable environment like: tripling of international oil prices, raising the monthly revenue from oil exports and raising the export surplus.

On the negative side, inflation rose to an average of 86% , ordinary persons found their wages falling by 30% and their pensions by 45%. GDP growth of 6. 4% in 1999 and increased to 10% in 2000. In 2001, the Duma passed a legislation to bring positive changes within the business and investment sector. Russia gained its economic stability despite of some challenges. In July 2002, The Government Concept of Automotive Industry Development came to existence. This new concept determined the goals, tasks and priorities in order to offer a package to combat the automotive conditions of Russia and its is applicable until 2010. In 2003, cumulative foreign investment increased by 50% or US \$ 29. 7 billion. Foreign Direct Investment rose by 69% or \$ 6. 8 billion. Industrial output in 2003 grew by 7% compared to 2002. To sum up, Russia's overall trade surplus during 2003 was \$ 60 billion , up from \$ 46 billion during 2002.

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The United States is one of the largest trade partners of Russia, saw exports raised by US \$ 3 billion. In 2003, US exports were machinery, meat, and electrical equipment.

According to the World Bank, Russia's GDP in 2003 was \$433 billion.

The country's GDP shot up to US \$ 1.5 trillion in 2004 making it the ninth largest economy in the world and the fifth largest in Europe. It is expected to become the second largest European economy after Germany and the sixth in the world in the near future. To have a promising economic development, a strategy should be maximized first.

Russian economic growth in 2005 was influenced by three primary factors. A continuing rapid expansion of domestic income and demand, improvement in the expectations of investors and growing competitive pressures from the real appreciation of the Ruble Russia. For year 2005, the Russian GDP was \$ 1.589 trillion with the real growth rate of 6.4% and inflation rate was 11.0%. There is a considerable progress in the Russian economy since liberalization([http://www. globaleconomicgovernance. org/Russia](http://www.globaleconomicgovernance.org/Russia))

Future of the Car Industry

The automotive industry of Russia is booming because of the annual car sales have increased from 800,000 in 1992 to 1.5 million in 2003. With the production of 120 million vehicles in 2005, Russia has been ranked as the thirteenth largest manufacturer of the vehicles in the world.

Backed by a booming economy, there has been a sudden boost in the demand for brand new domestic as well as foreign vehicles. Since the opening of the Russian economy and the rise of in consumer spending, central and Eastern Europe have become major sales markets of the automotive industry. Sales soar high with an annual average of 7.3% to 3.4 million units in 2004.

Foreign players present in the Russian automobile market include Ford motors, general motors, Renault, BMW, Kia Motors, Hyundai and Scania Motor Corporation.

With this scenario, it is very positive that the car industry in Russia is a great potential market surpassing other countries that are with the same business venture.

The claim that the car industry of Russia is a potential source of boosting the economy is visible. In 2003, the ownership of cars increased to 152 vehicles per 1, 000 inhabitants which is almost thrice the 1993 rate of 59. Another proof that the car industry of Russia is booming because of the annual car sales have increased from 800, 000 in 1992 to 1. 5. million in 2003. With the production of 120 million vehicles in 2005, Russia has been ranked as the thirteenth largest manufacturer of the vehicles in the world. Backed by a booming economy, there has been a sudden boost in the demand for brand new domestic as well as foreign vehicles.

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Roland Berger has a great forecast that by year 2014 as many as 2. 3 million new cars will be sold in Russia. With this positive development, Russia is expected to be one of the most growing markets in the world after China. The study claims that between 2004 and 2014, each year will have 100, 000 more new vehicles.

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Opportunities and Competitive Challenges

Roland Berger's survey said that Russia cannot connect to the world car market unless its economy improves still further. The following considerations should be put to action: reduce import duties on components for assembling vehicles and modules. It should also tighten its technical standards for products. In addition, Russia should attract more foreign investment, through investment agencies or special economic zones/areas. According to the same study, a modern and international competitive automotive industry in Russia would create around a million jobs.

A key element of the competition in the Russian motor industry is the ability to produce at low – costs – lacked by most European and American carmakers. Russian carmakers geared their systems to produce highly complex high – value products. The Russian motor industry must therefore to strive to maintain a fair share in Russian market, while radically expanding into the international market. The automobile industry has a great influence in market share and to Russia's increase in GDP. First, the automotive

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companies need to have a workable strategies and targeted management. Second, there is a need to stabilize the economic and legal framework in order to take advantage of the country's low labor costs and the size of its economy.

Let us be positive that Russia has the potential to become a major automotive base for the export of vehicles and components to the rest of the world. Russia has the ample supplies of many of the world's most valued natural resources especially to support a modern industrialized economy.

Despite of these challenges, transformation in the industry offers new opportunities for Russian carmakers and suppliers. A study conducted by Roland Berger showed that joint ventures with foreign companies offer suppliers an excellent opportunity of looking into international standards.

Conclusion

Fuelled by booming economy and political stability, the automotive industry in Russia has grown at an exemplary speed in the recent years. With the production of more vehicles in 2005, Russia was ranked as the thirteenth largest manufacturer of vehicles in the world. Backed by the booming economy, there has been a sudden

boost in the demand for brand-new domestic as well as foreign make vehicles, which has almost clean swept the foreign used cars market in Russia.

As per Industry research analysts, the growth in the demand of foreign brand vehicles has gone far beyond the best of the predictions made by them. In

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the long term, Russia shall be a prominent market for both production and sale of automobiles. As per our research, sale of new cars will reach 2.3 million in Russia by 2014. Also, a number of international suppliers shall have their presence in the country.

During 2005, the global automotive market demonstrated a consecutive seven-year expansion. Our experts estimate that, in 2006, there will be a slow down in this constant growth but this phase wouldn't be long lasting. With emerging economies playing a powerful role in the growth, the market will recapture its present escalation

With this case analysis presentation, I may say that Russia will become a superpower nation in terms of car industry after 10 years.

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