

Overview of the australian automotive industry economics essay



**ASSIGN
BUSTER**

This paper discusses the Australian automotive industry in depth, starting with developing an understanding on the structure of the industry and familiarizing with the key market players. It further elucidates the industry's performance over the decade, discussing at depth the positive and negative impacts of globalization from the benefits to the Australian consumers and increase in exports to the declining share in the domestic vehicle sales, ranging from factors like change in customer tastes, GDP per capita and the exchange rate.

Overview of Australian Automotive Industry

The Australian Automotive Industry consists of three major oligopolistic vehicle producers; Ford Motor Company of Australia, GM Holden and Toyota Motor Corporation, Australia. One of the motor vehicle producers in Australia, Mitsubishi terminated its operations in Australia in March 2008; however it continues to import the automobiles. Moreover, 200 producers in Australia supply components and 500 firms provide tooling expertise for the facilitation of the Australian Automotive Industry. (Australian Government: Department of innovation, industry, science and research, 2008)

In addition to that, Australia is one of the 15 countries in the world having the skill to take the car from perception to completion. With the proficiency in areas such as engines, panels, braking and clutch systems, suspension systems, exhausts, transmissions and rear axles, air conditioning, occupant safety, vehicle instrumentation, electronics, lighting, mirrors, wheels and tires to the expertise in R&D, engineering, design, product development and advancement, Australia has the potential to sustain and expand its

Automotive Industry. ("Australia's Automotive Industry", 2004)

<https://assignbuster.com/overview-of-the-australian-automotive-industry-economics-essay/>

Due to the technological advancements and the international competitive environment, the automotive industry is constantly reshaping and restructuring. The employment in the Australian Automotive industry is divided amongst the four major groups.

The major portion of employment is in the Automotive Industry constituting 40% of the industry's employment share followed closely by the Component manufacturers at 32%, and then the motor vehicle body manufacturing and the last to be the electric and instrument manufacturing constituting 23% and 5% respectively.

(Source: Australian Bureau of Statistics, 2007)

Effect of Globalization

One of the key benefits of globalization is the reduction in Tariffs throughout the world to increase the promotion of trade between countries.

Below is a bar chart (Table 1) which reflects countries and their reduction in tariffs on the import of Passenger Motor Vehicles. Japan has Zero percent tariff on imports, followed by United States (2.5 percent), then UAE (five percent) and 10 percent tariffs in European Union and Australia.

However 25 years back in 1984, Australia's tariff on Passenger Motor Vehicles was 57.5 percent. Now, the tariff of Passenger Motor Vehicles has reduced to 10 percent, and the Australian Government has plans to decrease them to five percent by January 2010. (Australian Government: Department of innovation, industry, science and research, 2008).

Table 1

(Source: Australian Government: Department of innovation, industry, science and research, 2008).

Due to globalization, Australian Automotive Industry has had many positive as well as negative impacts, which we will comprehensively deal with

POSITIVE IMPACTS

Increased exports

The reductions in protectionism throughout the world have benefited Australian automotive export. Due to the lower tariffs, the component producers have been able to export to different countries, these exports primarily constitute engines, braking systems, mirrors, propeller shafts, heating, ventilation and air conditioners which are imported by some of the largest of world's importers including US, North America, South Korea and even China. While Australia's anti-theft systems are demanded globally. (Year Book Australia, 2005).

The Australian exports of the completely built up Passenger Motor Vehicles, its derivatives and the Sports Utility Vehicles have also increased from 83, 205 units in 1999 to 140, 243 in 2007, an increase in exports of up to 68 percent which is also reflected in the bar chart (Table 2) below.

Table 2

(Source: Key Automotive Statistics, 2007)

Free-trade ventures and Australian Automotive Industry

One of the reasons why Australia cannot penetrate its exports into every country because of the country's higher tariffs. The chart (Table 4) below compares the effect of tariffs on Exports between Middle East and ASEAN (Association of South East Asian Nations). UAE for example, which is a part of Middle East, has a 5 percent tariff on import whereas countries in ASEAN such as Malaysia and Philippines has 30 percent tariff on imports.

Table 4

(Source: Key Automotive Statistics, 2007)

The exports in Middle East have increased gradually whereas the Exports in ASEAN have been relatively less and stagnant. One of the major reasons that the Australian Automobile Manufacturers could penetrate in the Middle Eastern Market is the lower tariffs.

In order to increase its penetration in the ASEAN and countries having high tariffs, Australia started to sign Free Trade agreements. Free trade agreement is a treaty between two or more countries which are meant to reduce or completely remove tariffs to trade.

On 27 February 2009, Australia ventured a deal with ASEAN (All South East Asian Nations) and ANFTA (Australian New Zealand Free Trade Agreement), with its agreement being effective no later than January 2010. The deal will assist Australia in increasing the number of exports, for this region as the import tariffs will subside gradually reflected in Table 5.

Table 5

(Source: Australian Government: Department of Foreign Affairs and Trade, 2009)

The table gives an example of Malaysia and Indonesia amongst the several countries in ASEAN and the decrement of tariffs due to FTA in the years following. Indonesia in 2008 had a tariff of 65 percent on new cars which after this agreement would gradually reduce to zero percent by 2019 whereas in Malaysia, the tariffs would decrease from 30 percent in 2008 to 5 percent by 2018.

AUSFTA (Australia United States Free Trade Agreement) and Australia Chile Free Trade Agreement went into force on 1 January 2005 and 6 March 2009 respectively which has further enabled the Australian Automotive industry to increase exports as tariffs on all existing merchandise will be eliminated by 2015 (Australian Government: Department of Foreign Affairs and Trade, 2009).

Negotiations are underway with China, Gulf Co-operation, Japan, Korea, Malaysia and the TPP (Trans Pacific Partnership) to collaborate and sign the Free Trade Agreement (Australian Government: Department of Foreign Affairs and Trade, 2009)

Free Trade Agreement indeed is a significant step taken for the Automotive Industry to increase the sales in the foreign market and hence achieve large scales of economy and ensuring competitiveness in the World Automobile Market.

<https://assignbuster.com/overview-of-the-australian-automotive-industry-economics-essay/>

Retail, Service and Repair Sectors

There are many sectors in the Australian Automotive Industry one of which is the Retail, Service and Repair Sector.

52, 000 people are employed in this sector and its functions include:

Distribution and sales of New Vehicles

Distributions and sales of Old Vehicles

Dumping and recycling of old vehicles.

Distribution and sales of accessories and parts.

Repairing and Servicing (National Industry Career Specialist Manufacturing, 2008).

The mentioned sector is growing as due to globalization, the sales of car/year have been increasing steadily as mentioned in Table 3 due to increasing GDP per capita and the affordable car prices domestically.

Table 3

(Source: Key Automotive Statistics, 2007)

Demographics of skilled workforce

Due to globalization, the trade and sales of every product is becoming extremely competitive. In the present as well as the future era “ productivity is important because the higher it is, the lower the prices, the greater the

output, the higher the return on capital, the higher the wages, and the greater the chance a business has of surviving” (Penn, nd).

The Australian automotive industry acknowledges this fact and is striving to improve productivity of employees as signified in Table 6.

Table 6

(Source: Key Automotive Statistics, 2007)

The average vehicles produced by an employee have improved from 15.5 percent in 1997 to 18.9 percent in 2007 as illustrated by the above chart; a rise of around 22 percent. The positive side, the productivity of employees is rising, as analyzed in the Ford’s survey of its 5000 employees from 1995 to 2007 is a result of growing number of educated professionals; 62.4 percent employees being TAFE qualified in comparison to 22.7 percent in 1995 (Australian Government: Department of innovation, industry, science and research, 2008).

This is indeed an optimistic sign for Australia as the present and future will have new and advanced technology, design, processing and therefore the upgradation of skills will be a key factor in providing the right human resource to the industry. The industries themselves are taking keen interest to develop and educate human resource by on the job training, concern and investments in the Technical and further education (Automotive Training Australia, 2007).

With globalization comes a stream of negative impacts for the Australian Automotive market which will be discussed below.

NEGATIVE IMPACTS

Unemployment

The manufacturing cost in Australia has become relatively high because of the higher wages, which are reflected from the GDP per capita of Australia 37, 299 GDP, (IMF, 2009). Therefore due to the cost of manufacturing being high, the component producers are gradually drifting towards countries having lower labor cost such as Asia. (Super Cheap Auto Pty Ltd, 2008) This in fact, is one of the factors decreasing the employment in the Australian automotive industry and is further illustrated by the bar chart below:

(Source: Key Automotive Statistics, 2007)

The chart depicts the gradual decrease in employment after 2003/04. After reaching its peak of employing 69, 800 people in the automotive industry, the employment has gradually declined to 67, 100 in 2005/06.

Scales of economies

(Source: Federal chamber of Automotive Industries, 2009)

As per the chart above, Australian automotive industry produced 324, 118 cars as compared to 408, 186 cars being produced in 2003.

The total cars manufactured worldwide in 2008 are 52, 940, 559

(Worldometers, 2009).

This level of production is relatively small, accounting for less than 0. 01 percent of world production.

Therefore, competing with countries which have larger scale of production advantage poses a big threat to the Australian automotive industry.

In order to sustain the global market competition, expansion into overseas market is vital to achieve scales of production.

Exchange Rate Issue

Exchange Rate has had a major effect on the domestic sales as well as the exports for the Australian Automotive Industry. The table below suggests that US dollar has depreciated in the past few years against the US Dollar. Therefore, this rise in Australian dollar has had a major impact on the competitiveness of the Australian automobiles.

(Source: Forecast chart. com, 2009)

The rise in Australian dollar means that the prices of domestic cars get relatively more expensive than the price of the imported car. Since the currency for most of the exports is in US Dollars, hence the price of the Australian car in the international market has also increased.

The volatility in the exchange rates can also impact the declining of the profit margins. For example, if Toyota wants to launch a car in US in July 2009. The full cost of the car in AU\$ is 25, 000. Toyota took a profit margin of 15%, on a full-cost basis with an Australian Price of AU\$ 28, 750. The exchange rate was 1. 29 AUD/USD, therefore Toyota and a target US Price of US\$ 22, 287.

But in August, the exchange rate declined to 1.19 AUD/USD. This led to two problems:

If Toyota Australia increases the prices of the car as per the exchange rate, the car will become competitively expensive which will pose a threat to declining volumes of sales.

If Toyota Australia fixes the price to US\$ 22,287, the profit margins of the car will decrease from 15 percent to 6 percent as signified in the table below.

Toyota

11-Jul-09

4-Aug-09

Full Cost in AUD

AUD 25,000

AUD 25,000

Profit Margin(@15%)

AUD 3,750

AUD 3,750

Australian Price

AUD 28,750

AUD 28,750

Spot Rate (AUD / US\$)

1. 29

1. 19

Base Price in US\$

\$22, 287

\$24, 160

Fixed Target Price in US\$(no effect of exchange rate)

\$22, 287

\$22, 287

Spot Rate(AUD / US\$)

1. 29

1. 19

Price Received in AUD

AUD 28, 750

AUD 26, 521

Less Full cost

AUD 25, 000

AUD 25, 000

Residual Margin

AUD 3, 750

AUD 1, 521

Profit Margin(%)

15. 00

6. 09

(Source: Exchange rates. org, 2009)

The above example reflects that the strengthening of dollar has had a key impact on the exports. Since the major exports is in the Gulf and the US are linked in the US Dollar.

Since the US Dollar has weakened, therefore the price index of the imported cars has dropped by 2%, and therefore imported cars in the domestic markets are relatively cheap than the Australian cars(Source: Australian Government: Department of innovation, industry, science and research, 2008).

However, on the other hand, the appreciation of Australian dollar has reduced the cost of importing capital equipment required for upgrading and expanding capacity. Impact on customer preference

Since there is less protectionism for imports in Australia, more countries have a gateway to export cars to Australia. This in turn, benefits the local consumer as they have a wide variety of cars to choose from and since there

are more players in the automobile market, the competition between the motor vehicle producers increases, making cars relatively cheap to attract the consumer.

The bar chart below illustrates the change in customer preferences from 1998 to 2007.

(Source: Australian Government: Department of innovation, industry, science and research, 2008)

In the past, Australian consumers had preference for large cars; in 2000, the share of the large cars in the Australian market was 35.9 percent with the sales gradually declining to 21.9 percent by 2007. The major domestic large cars in Australia are Holden Commodore, Falcon, Fairmont, Camry 6, Vienta, Avalon, Aurion, Magna 6 and Verada. While it is interesting to note that the share of imported large cars have increased slightly; from 1.1 percent of sales in 2000 to 2.4 percent of sales in 2007, again showing the increase in buying potential of Australian consumers (Key Automotive Statistics, 2007).

The majority of sales in the Australian Automotive Market now comprise of Light/Small Cars; 56.6 percent of the total cars sold in Australia in 2007 were light / small cars as compared to a 44.1 percent share in 2000. Australian automobile industry do not manufacture light/small cars, hence 100 percent of the light/small vehicles in the Australian market are imported (Key Automotive Statistics, 2007).

The medium segment of the cars had a 7.3 percent share in 2000 which has increased to 14.5 percent in 2007. The share of the local producers in this

market has decreased slightly from 4.5 percent in 2000 to 4.1 percent in 2007 while the sales of imported cars have increased 4 fold from 2.8 percent in 2000 to 10.4 percent in 2007 (Key Automotive Statistics, 2007).

The sale of the SUVs (Sports Utility Vehicles) has also increased from 13.4 percent in 2000 to 18.9 percent in 2007 (Key Automotive Statistics, 2007).

There has been a significant change in the demand for cars bought by the consumers in the Australian market. The data reflects that the customers are shifting their preferences from buying a Large Car to buying a Light / Small Car and, followed by SUV's and Medium Cars in a descending order.

A research by Wilson (1995) stated that the Australian consumer's inclination depends upon factors such as safety of the vehicle, fuel prices, environmental impact of cars and the road system. Hence, the increase in the sales of the small cars is due to their fuel efficiency and environment friendliness. However the customers' preference for luxury cars such as SUV's has also increased although they are less fuel efficient but the customers are fond of differentiated imported models.

Wilson (1995) conducted a survey 14 years back in 1995 indicating that 63 percent of Australian consumers would prefer to buy a local car rather than an imported car. However, majority of the people who were in favor of protecting Australian Automotive Industry had not completed post school qualifications - 70 percent, while the percentage of consumers having university degrees who responded in favor of protecting the Australian Automotive Industry were only 29 percent. Hence, we can believe that those people who had completed higher education were in favor of reducing tariffs

<https://assignbuster.com/overview-of-the-australian-automotive-industry-economics-essay/>

for international competitiveness and efficiency. The people having completed an undergraduate degree have increased from 15 percent in 1996 to 24 percent in 2008. (Australian Government: Department of Education, Employment and workplace relations, 2008). Hence, it can be deduced that today more people in Australia are gradually drifting from national sovereignty to global competitiveness; being one of the factors for the increase in sales of imported cars.

The negative effects which include the strengthening of the Australian dollar, the reduction in tariffs, the higher manufacturing cost due to expensive labor and lesser scales of economies, and the changes in consumer habits have led to the sales of the domestic cars within Australia to decrease which is also mentioned in the Table below.

(Source: Key Automotive Statistics, 2007)

In 2007, the domestic cars sold in Australia were 157, 262 units, whereas the total imported cars sold were 479, 757 units. Out of every 4 cars sold in Australia, only one was a domestic motor vehicle. The key statistic to note is that out of the 479, 757 units of imported cars sold, 360, 279 units were light/small cars and zero units of locally produced light small cars.

Combating Measures

Australian automotive industry did not capitalize on the segment for small/light cars which generated the majority of sales in the Australian automotive industry. Tcha and Kuriyama (2003) suggest that after Toyota's withdrew its production in 1999, no company produced small cars in

Australia.

<https://assignbuster.com/overview-of-the-australian-automotive-industry-economics-essay/>

Best Practices of giant players

Seeing the popularity of smaller/lighter vehicles in the domestic market due to the fuel efficiency and the changing lifestyles of consumer, Ford is planning to start the production of its new model named Ford Focus (a small, fuel efficient and pro environment car). The production of Ford Focus will start in 2011 which also is expected to create 300 jobs in the Australian market and provide opportunities for business to the component producers. Ford focus will primarily be engaged in selling its cars locally and also exporting them primarily to New Zealand and South Africa (“ Ford to manufacture small cars in Australia”, 2007).

Like Ford, Holden, another automotive manufacturing concern, has similar plans to build a small car due to shifting paradigms of customer preference in Australia. Holden is engineering its technology for better fuel economy, with a possibility of providing alternative fuels such as Compressed Natural Gas, LPG and E85 (Kuby, 2006).

Research and Development

Australia is one of the 15 countries in the world which can build a car from the scratch till the end. Due to the technological and expertise advantage, Australia has started to invest more on the Research and Development. Along with R&D, Australia is also taking measures technological advancements in the tooling industry. It is also improvising on supply chain and the productivity of employees (Australian Government: Department of Foreign Affairs and Trade, 2009). The chart below suggests a steady increase in investment on R&D annually in the ten year period from 1996 till 2006 (AusIndustry, 2007).

<https://assignbuster.com/overview-of-the-australian-automotive-industry-economics-essay/>

A living example of the benefits of investment into R&D is Toyota Australia which made record profits for the year 2007 to 2008 and the reason of their success is determined investment on human capital and cost effectiveness despite the adverse market trends as illustrated in the comments of their President, Mr. Max Yasuda (2008) in a Press conference said that “ In our market, I expect the local car-makers will continue to see increased pressure on profitability from manufacturing operations, in spite of strong revenues from imported vehicles.” (Pettendy, 2008) Hence the competition will increase as the years pass along with the boundaries of protectionism gradually dissolving reducing the profitability of the manufacturers. The reason for success can be best described by his statement “ Since 2002 we have invested about \$900 million on investments aimed at cost and efficiency improvements. In addition, we have invested in improving employee skills and initiated a company-wide program aimed at improving efficiency and reducing costs across all parts of the business” (Pettendy, 2008).

Australian government acknowledges that the Automotive Industry is of strategic importance to the economy and therefore, Australia Competitiveness and Investment Scheme (ACIS) is investing huge funds on R&D, in order to improve and explore the horizons for new technological break-throughs in green and fuel-efficient cars. Due to the high wages and high skilled labor, the survival of the automotive market is dependent upon new technologies which can then increase the number of exports and competitive advantage resulting in super normal profits(AusIndustry, 2007).

Conclusion

We have demonstrated that the Australian automotive industry is facing increased competition due to the stronger exchange rates, relatively expensive labor cost and lower international tariffs. The research presented by this paper supports that the market share of Australian motor vehicle producers has declined significantly over the last decade. Furthermore, this discussion reveals causes for this slump, primarily highlighting the industry's failure to identify and respond to the pulse of its consumers hence losing its share to competition.

Towards the solutions front, the paper discusses some success stories deriving from them corrective recommendations to address the ailments of the industry, concluding through examples of Holden and Ford that the best corrective measure lies in the re-engineering of production towards trends of small, environment friendly and fuel efficient vehicles. Moreover, it also suggests adoption of practices to drive the cost of production down by restructuring the manufacturing operations and effective supply chain management- all in all position the business to reap maximum benefits of globalization and pay minimum costs.