

# Exports – The Who, Why & When

In school, chapters on basic trade taught us that if you produce something cheaper than others, you have an advantage.

It is likely that the others may decide to buy the thing from you than producing it themselves. At times, the 'cheap' may be replaced by 'unique' and the advantage becoming even stronger. This is how world trade moves – the Middle-East produces oil cheaper than everyone else and so they export it. Ditto for coal and iron ore from Australia. On the other hand, heavy machines from Germany and fighter planes from a select few countries are examples of unique. To a certain extent, that is.

In a nutshell, commodity exports are governed by cheap, while product exports are governed by unique. However, the unique starts losing its edge when it starts moving towards being a commodity. So if fighter planes are being produced by France, US, Russia, UK and Germany, a country like India starts looking at them as being a commodity to a certain extent. If all of them tick the required boxes, it is the price that becomes the deciding factor. So the 'cheap' becomes more relevant and the product has moved towards becoming a commodity.

However, things would be different if India was in the market for a more advanced Generation – V fighter plane with stealth capability. This would eliminate everyone except US, which has the F-22 Raptor (random assumption that they are offering it in the market) and then the product consideration for trade again shifts towards 'unique'. In such a case, US certainly would export the Raptor and cannot be beaten by another country.

## Cars – moving towards a commodity

Cars are a different ballgame. We assume that they are unique products. However, look deeper and they are a product fast moving towards the commodity side of the curve. Sure, they need to be manufactured, which means that they are a product. However, a country's strategic advantage in producing cars has diminished to such an extent that most of the time, one cannot think of exporting vehicles based on some unique aspects of the products. Or just by geo-tagging.

## Geo Tagging

Geo tagging as a concept works the best for food products as it imparts a uniqueness that consumers can associate with it – Scotch has to come from Scotland and cannot be bottled in Dharavi; wines come from various places and they are labeled on the bottles; and Champagne can come from only a certain region in France, the others have to invent new names for fizzy white wines.

As an extension, when food products become a commodity then it is again cost arbitrage which decides if a country would be exporting the same. So Maggi noodles are exported to many developed countries from India because Nestle can produce the damn noodles the cheapest here.

The car business is one of the most global businesses. There are Japanese manufacturers, German car companies and there are American and Korean manufacturers. Then there are also oddballs like Italian, French, Chinese and Indian manufacturers.

However, look deeper and this differentiation has just been reduced to rhetoric – German carmakers produce in Austria, South Africa and India, Japanese manufacturers produce in Thailand, India and UK, Indian manufacturers produce in

Thailand and dream beyond, and so on.

One can argue that geo-tagging of hi-tech products (like cars, computers and smartphones) should not be done on the basis of the location of the manufacturing facility but more by the location of the development centre. So an iPhone can be produced in China, it still proudly proclaims, 'Designed in California'.

Similarly, a BMW ought to be designed in Germany. However, things start losing their black-and-white texture as we come down the uniqueness scale. Beyond the prestige brands like Apple and BMW, the rest are losing their geo-tagging edge rapidly. So Suzukis are being designed in India, Fords in Australia, Toyotas in South Africa and so on.

Arguably, the situation would dilute even more as cars, much like computers and smartphones, are an amalgamation of components. Manufacturers are essentially system integrators and suppliers the real technology developers. A car manufacturer integrates technology from global components suppliers, providing an exoskeleton of character defined by chassis and engine development. Arguably, it is this exoskeleton that defines the car's characteristics and its edge over others.

## So how does one export?

Which brings us to the critical question – if cars are not a commodity and have lost their edge as a product, how does one export them? Is the case as simple as manufacturing it the cheapest? If that is the case, why isn't Bangladesh exporting cars to everyone?

For that matter, why isn't Bangladesh exporting boats to everyone?

Arguably, it is the fluid situation for the car – hanging between a commodity and a product. That also defines the export dynamics. Car manufacturing is not just all about labour costs. There are numerous other costs involved, including material, development, logistics, corporate costs, promotion & communication, dealer margins, and amortisation. Cheap labour is not as important as it is made out to be even though it does define the extent of automation and robotisation in a car plant.

Labour costs in a developed country often comprise of more than 20% of the car's final cost. Considering the wage difference on the manufacturing side between India and the developed world is huge, there is an inherent advantage for India. For an average of USD 48 / hour for a worker in Germany, Indian companies only pay USD 2 / hour for a plant worker. However, this gain in labour costs is often offset by a huge loss on account of logistics costs.

## **Exports – Looking Beyond Simple Cost Mathematics**

However, the car industry has to look beyond just simple mathematical equations as there are many other elements that complicate matters.

The first amongst them is taxation. As trade between countries increased, some started fortifying themselves against a trade invasion by creating tariff and non-tariff barriers. Others got together and realising their similar objectives and often similar geographical locations, started forming trade blocs where members enjoyed zero or very low taxation on intra-member-countries' trades. This effectively meant that imports from non member countries would be automatically more expensive.

And then someone invented the Free Trade Agreement (FTA), an agreement that imparted zero or very low duties on goods

imported from countries that had come together to sign the FTA. While the signing countries may not be part of a formal trade bloc, the FTA was essentially creating similar conditions.

For passenger vehicle exports, this meant that some countries were more kosher than others.

## Exports – Further Complications

But if it was just about the cost arbitrage including the tax implications, all carmakers would have behaved in the same way. So if a Hyundai or Nissan is exporting a hundred thousand cars every year from India to Europe, so should a Ford or GM or Toyota or Volkswagen.

Except they don't.

Beyond all the mathematics, all the calculations, there are other aspects of the business that have an impact on the export status of a country. Let's examine some of them in details:

**1. Prior Commitments:** If you are a global carmaker with a widespread manufacturing footprint, you already have multiple manufacturing locations across the world. Considering that the global economy had tanked just a few years back, it is highly likely that some of your plants may be running under capacity. In that case, is it prudent to invest in even more capacity in India just to export cars?

**2. Prior Favours:** As an extension to the above, it is likely that while setting up some of your previous manufacturing plants, you took favours from the local governments. These may include cheap land, tax breaks and trade benefits. Exporting from India to these markets may mean doing a turnaround on some of these prior commitments, an arguably pissing scenario for other governments.

**3. Employment, Unions & Global Politics:** As a further extension to the above, employees don't like the idea that the next generation of the cheap hatchback they have been manufacturing over the years would now be sourced from India. They revolt, protest and make such a move very messy. Considering that some of the carmakers like Fiat and Volkswagen are also politically charged, such moves have to be done very carefully. At times, they are avoided altogether. However, if the product is something unique like a Vento or Vento Compact, then exporting from India is not a problem.

**4. Logistics:** As we mentioned earlier, logistics costs are insignificant as long as the consumption is local. Try crossing a couple of oceans and things fall apart. Logistics costs are a prime reason why a car manufacturer now thinks of setting up a plant in Gujarat, and not Chennai / Ennore, for shipping to the Middle-East, Africa and Europe.

**5. Model Cycles and Outdated Models:** The global economy is divided into three zones – developed countries, developing countries, and under-developed countries. While some of the promising developing countries, especially the BRICs are now well penetrated by global car manufacturers, it is the under developed countries that hold the most promise, and pose the biggest challenge, to carmakers. A land mass like Africa has about twenty promising economies that would emerge as major car markets in the next decade. Even Africa taken as a sum of many trickles is a promising entity as of today. However, its under developed status means that what sells in Europe may not be palatable in Africa. The last generation model from India may just be the right choice for under developed economies. For example, Hyundai India used to export more than half the production of the old generation Accent compact sedan. So not following the global lifecycle to the dot may turn out to be beneficial for India at time.

## Small Cars – The Big Export Story

Simple business logic tells us that the more you make of something, the cheaper you can turn it out. This is a basic principle that is true for nearly everything, from commodities like crude oil to hi-tech microconductors. This is especially true for the automotive industry, an industry which thrives on scale. Suppliers are always keen to run their plants at the full capacity even if it means offering lower prices on a per unit basis. A plant running at full capacity would make up for any price discounts. A price discount by the supplier would effectively lower the cost of the final product, making it even more exportable.

So scale is the primary concern. In essence we would like to pursue exports of something that is already very popular in the domestic market. One needs to start with products that already have large economies of scale. That explains best why Bangladesh has little chance of becoming a major car exporter in the near future.

Small cars fit the bill. Due to tax benefits and their cost advantage, they are already hugely popular in India. The country is the largest manufacturing base for A & B segment cars worldwide and arguably the cheapest manufacturing base. This means that most suppliers have good economies of scale. Any export volume would be added leverage for the OEM and drive costs even lower, benefitting sales even further.

That explains why Hyundai, Maruti-Suzuki and Renault-Nissan have used India as a small car manufacturing base. Hyundai has been exporting more than 50% of its output for many years now while Maruti-Suzuki has been used as the global manufacturing base for a few Suzuki models in the past. Nissan also uses the Oragadam plant a sourcing hub for the Micra & Sunny / Almera models.

Extending the argument of large volumes benefitting exports,

one can also see the start of a trend for exporting compact sedans, compact SUVs, compact MPVs and small trucks. Some of these vehicles have evolved in India but their strong acceptance is an indicator that they may have a good market in other developing economies as well.

## The Advantage of Exports

While the direct advantage of exports in driving volumes are visible, there are several other advantages that we would like to point out:

**1. Incremental volumes:** Exports bring substantial incremental volumes that helps suppliers install larger capacities and keeps their plants running. They in turn can offer better prices and terms to OEMs, improving the OEM's profits and margins.

**2. Better Insurance:** The Indian market is a developing market and most global carmakers get it wrong at times. Often, this results in strong deviations from RFQ volumes, something that hurts suppliers badly. Support from exports irons out such problems and provides some sort of insurance to the supplier. Consequently, they are more enthusiastic about programs with a good export potential and more willing to offer better pricing on such programs.

**3. Improved Margins for OEMs:** Exports are mostly done at a more favourable price than domestic sales. Export vehicles also have a richer trim level and this also helps in margins. Also, exports mean that the OEM's own plant is enjoying a higher capacity utilisation, improving profitability.

**4. Faster percolation of Technology:** Technology elements like LED headlamps and advanced body electronics are more prevalent in the export variants. However, their significant volumes drives down their supply costs and helps their percolation in the domestic variants as well.

**5. Propping up deadwood:** Consider you are a dead manufacturer, one with multiple failures in the past and volumes fast



approaching zero. Suppliers have lost all trust in you and any RFQ you float in the market is met with guffaws. One of the best ways to potential resurrection and to get a second chance from suppliers is to announce that India is now part of a major exports push. From Fiat-Jeep, Volkswagen to GM, a number of carmakers are increasingly using this tactic. Final success may be analysed five years down the line but for now supplier confidence has been restored.

## How do Carmakers Perceive Exports

Depending on their exports strategy, EMMAAA divides carmakers into three categories:

**1. Been there, done that, moving on:** These are carmakers who committed themselves to exports a long time back. However, their current strategy is focussed more on domestic sales. Hyundai is the prime example in this case. At the start of its innings in India, Hyundai made India the exports base for its small car, Santro. Later on the same privilege was extended to the i10 and i20 hatchbacks. However, persistent labour strikes and a clogged Chennai / Ennore port pissed off the Koreans somewhat and they opened a plant in Turkey, moving most of the Europe bound exports from Irrungattukottai to Europe. The new generations of i10 and i20 have not been given the VIP exports treatment that the previous generations enjoyed. Considering that the company is taking it easy on production capacity expansion in India, it is clear that they will focus on domestic business more than exports. We feel that Renault-Nissan would eventually move in Hyundai's strategic direction a few years down the line.

**2. India part of global strategy carmakers:** Then there are carmakers who have to look at the parent organisation for their big time export push. Maruti-Suzuki is the key amongst these. The company may have a big production base in India, the export of a model is still a central Suzuki decision. So while the last generation A-Star / Alto / Pixo was exported

from India in large numbers, the Celerio has not been given such a favour. Instead, European exports of the Celerio happen out of Thailand where Suzuki needs those production volumes to meet its Eco car requirements.

**3. The Indian:** These are Tata and Mahindra, companies who have ambitions less than none. Exports are a part of their strategy even though their products have not quite yet reached the level where they would be globally acceptable.

**4. Exporting to move into the big league:** These are carmakers who have had reasonable success in the past. They now want to move into the big league. Setting up an exports centric plant is the next big one for the local management and it also helps in driving costs down for the Indian market. The prime example of this strategy is Ford. Moving into this direction eventually would be Honda.

**5. Exporting to Buy Time:** These are carmakers who have faced rough weather in the recent past and look at exports as something to buy time. Let's count Volkswagen and Toyota in this segment even though the Japs are smug and haven't committed to exports yet.

**6. Exporting to Survive:** These are carmakers who need to export to survive. They have been in rough weather since their birth and have very little hope, so run down is their brand. Fiat and GM fit the bill here.

## **Exports – How Does India Shoot Itself in the Foot**

What India got right on the policy front, it undid at the execution side. While the tax benefits to small cars ensured that they became the fastest growing passenger vehicle segment, the slow pace of infrastructure development ensured that actual exports stayed nightmarish. Carmakers exporting out of the country suffered because of clogged ports and handicapped logistics to the port itself. Things haven't improved tremendously though the future crop of exporting carmakers will likely shift cars out of Mundra in Gujarat on

the West coast and not Chennai / Ennore on the East coast.

Reforms are also needed on the labour issues side. Labour laws in India are archaic and makes manufacturing in India tougher than its supposed to be. While governments in the past & present have promised reforms to the labour laws, the touchy subject has not been poked yet. As a result, labour strikes are not infrequent and the disruption affects the exports side as well.

## The Next Big What?

Changes are also happening in the way carmakers, especially the larger ones, treat exports. Earlier, exports were a central prerogative and the Indian operations were nothing more than a factory. So Hamamatsu and Korea decided how many cars needed to be shipped and to where. They also decided pretty much everything else on the trade side.

With the increase in size of the Indian operations and with persistent executives on the so called international desks asking "What do I do next?", global carmakers have reluctantly given a free hand to the Indian operations to seek out new exports markets themselves. This is a win-win for everyone. Hungry Indian executives have gone ahead and opened doors in several under developed markets. These are completely new markets that have never been on the horizon earlier and where the parent company was not selling anything yet.

This works well for established carmakers as when they move exports to established markets out of India, the loss in volumes can be compensated by someone else.