OLIVER WYMAN

M A N A G E M E N T S U M M A R Y

Oliver Wyman Study on "Commercial Vehicles 2015"

Economic Upturn Hides Structural Problems: Riding The Tide Isn't Enough

- **Industry-wide profits over the business cycle are too low**
- **Further consolidation in the sector is foreseeable**
- **Focused manufacturers are today's profit champions**
- **Globalization and revamped business designs offer opportunities for value growth**

Despite the healthy bottom lines currently appearing in the commercial vehicles sector, most Western European manufacturers hardly manage to cover their capital outlays over the business cycle. The causes lie in structural problems of the industry: the home market in Western Europe is hardly growing at all, business in new vehicles is largely unprofitable, and manufacturers suffer from high fixed overhead. In its current study "Commercial Vehicles 2015" Oliver Wyman analyzes the industry-wide trends and outlines models for coping with them. It also unveils several promising strategies for Western Europe's commercial vehicles manufacturers, including continuing globalization, streamlined operations, and structural changes in their business designs.

Over the last few months, commercial vehicle manufacturers have reported impressive increases in sales revenue and profits. But Oliver Wyman's latest study "Commercial Vehicles 2015" shows that these encouraging figures are mainly the result of an economic upturn that will sustain the heavily cyclical commercial vehicles industry until well into 2006. Looking at the entire cycle from 2002 to 2009, the sales figures for Eastern Europe and North America are growing at almost six percent and those for Asia and South America at some 2.5 percent. The Western European market, however, is stagnating at a meager 0.7 percent per annum.

Nor is there much movement in market shares. In recent years not a single manufacturer has managed to significantly increase its share of the European market, despite the many campaigns announced by various brands. On the contrary, the battle for market shares has merely left a mark in low profits. Seen over the entire cycle, the EBIT margins of the four largest European manufacturers - DaimlerChrysler, Volvo/Renault, Fiat/IVECO, and MAN – have remained at a minuscule three percent. Many manufacturers have not been rigorous enough in adapting their business designs to meet the changing conditions of an increasingly mature market. Now they'd better use the economic upswing over the next one or two years to gird themselves for the coming challenges.

Further globalization is imperative

Europe continues to decline in significance as a sales region for commercial vehicles. In 2009, only a projected 312,000 of the 1.9 million trucks sold worldwide will be purchased in Western Europe, as opposed to 800,000 in Asia and 545,000 in North America. Major peripheral markets in the global business scene are Eastern Europe, with a potential for 160,000 trucks in 2009, and South America with roughly 100,000 units. A large majority of the experts Oliver Wyman consulted feel that commercial vehicles manufacturers often overrate the significance of the boom in Eastern Europe. True, the region is witnessing healthy growth, but the absolute quantities attainable there are relatively small.

The Oliver Wyman study demonstrates that a strong presence in the non-European growth regions is a sine qua non for commercial vehicles manufacturers. Granted, Asia will grow less than Eastern Europe or the NAFTA countries over the next five years, but even in the middle term hardly a single manufacturer will be able to make do without the growth impulses expected here. Our study makes it clear that globalization will have to remain among the companies' top priorities. China will surely play a central role in this, though the current China hype runs the risk of concealing growth opportunities in other regions. The study finds globalization problems mainly in the availability of decent suppliers, in the protection of expertise (especially in China), and in setting up the necessary full-coverage service organizations.

Room for operational improvements

The Oliver Wyman study advises manufacturers to exploit their current high earnings not only for regional expansion, but to further optimize their business designs. Potential for efficiency enhancement continues to lurk in administration, development, purchasing, production, and sales. Particularly in the latter, it is essential to implement more direct processes, tighten the organizational structure, and streamline sales management, thereby getting closer to the customer and improving the company's muscle power on the market.

Moreover, the study continues, the use of systematic methods of market and customer research is underdeveloped among many commercial vehicles manufacturers compared to other investment-goods industries. Commercial vehicles manufacturers usually have few 'hard facts' on their customers' preferences. For example, they don't know whether their customers consider a tighter service network more important than faster delivery times, or how much they value these improvements at all. The companies thus lack the data they need to make their strategic investments.

Admittedly the sales headquarters of commercial vehicles manufacturers have gradually realized that the customer's decision matrix covers far more than just the product and its price. For example, it also includes financing costs, availability, capacity exploitation, and value depreciation. They've also come to realize that they need a far deeper understanding of their customers in order to achieve a genuine competitive edge. But they still have a very rough time converting these realizations from "in situ" sales operations into a practical sales strategy.

Safeguarding profitability in sales and service

As a rule, the sale of new vehicles involves enormously time-consuming and cost-intensive sales structures. Today manufacturers earn nothing or next to nothing from new vehicles. The most significant source of earnings in the commercial vehicles sector lies in the sale of original parts. Yet, thanks to copycatting and the gray market, the profitable spare-parts business is coming under increasing pressure. At the same time, vehicles have become more reliable in recent decades. This and the increasingly long maintenance intervals have brought about a drastic drop in number of service hours per truck. The growth of the vehicle fleet has not been able to compensate for these developments, and service networks threaten to run deficits as a result. Nevertheless, service networks remain a major strategic asset for commercial vehicles manufacturers. Rethinking the service network concept will be one of their key strategic tasks over the new few years. Companies should also examine models in which manufacturers relinquish control over their service network or share it with a competitor.

In sales, too, far-reaching structural changes are essential. As hauling companies become increasingly large – and their purchasing policies more professional – it is crucial to add professional key account management and industry-specific sales approaches to conventional full-coverage operations. Moreover, the commercial vehicles industry must boost the profitability of its sales systems by streamlining structures at the manufacturer and importer level.

Another previously neglected opportunity, the study continues, is the market for used vehicles. Business in used vehicles has the potential to mutate from an expensive adjunct to the new vehicle sector into a major sales channel. Not only that, it is a sector with great strategic importance for the development of new markets. The prerequisite, however, is an independent used vehicle business design with proactive and globally aligned distribution and marketing operations.

From truck manufacturer to integrator and mobility service provider

The Oliver Wyman Study pinpoints several long-term trends in the commercial vehicles landscape and shows where manufacturers will have to aim their strategies in the future – from the present-day focus on technology and production towards the customer and higher-value services. This calls for new business designs to ensure more differentiation in the competitive environment and to open up profitable new lines of business.

Today commercial vehicles manufacturers follow extremely capital-intensive business designs that are manufacturing centered. According to the study, this was fine as long as manufacturers could differentiate themselves via their products and effects of scale still had no major impact on costs. But this is no longer the case. Consequently, manufacturers would be well-advised to shrink the depth of their value chain, e.g. by outsourcing fuel tanks, axles, and other components and subsystems that customers consider interchangeable.

The capital this would release should be invested in activities closer to the customer, such as sales, or in higher-quality services. At present, the service spectra of commercial vehicles manufacturers are largely indistinguishable: customers, however, make note of tangible differences in quality and professionalism in the services rendered in sales and aftersales, both of which will play a key role for manufacturers in the future. Here Mercedes-Benz sets industry-wide benchmarks, for example with the Branch Information Center (BIC) at its commercial vehicles plant in Wörth, or with its service subsidiary Charterway. In the future, it will be of critical importance to offer all-inclusive integrated service and solution offerings, not only to round off the product assortment, but also to function as a source of additional income with its own business design.

In a radical scenario of the future, the Oliver Wyman consultants envision business designs in which commercial vehicles manufacturers function more like integrators and provide their customers with mobility rather than merely selling products. There are four key success factors for the necessary revamping of commercial vehicles manufacturers' business designs: globalization to achieve critical mass; streamlining to maintain the best possible competitive position despite constantly tight margins, a shift of emphasis along the value chain to bind capital only where it will produce value-added for the customer, and a customer alignment in order to offer tailored solutions in the future rather than interchangeable products.

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The Study

Oliver Wyman's "Commercial Vehicles 2015" study is based on fifty interviews with experts, its own wealth of experience in project management, and an interdisciplinary analysis of available industry studies, analysts' reports, statistics, and publications. The study focuses on the segment of commercial vehicles weighing over six tons.

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Six Industry-Wide Trends in the Commercial Vehicles Market

1. Mass Extinction of Medium-Sized Hauling Companies

Most of the future customers for commercial vehicles will be either professional purchasing agents from large hauling companies requiring key account management, or very small customers who continue to need full-coverage sales operations.

2. Grim Prospects for Cheap Trucks

There will be no victory celebrations for generic trucks from low-wage countries. The obstacles they face include the tight legal stipulations placed on motor vehicles, the relatively minor significance of vehicle price compared to total expenses over the full lifecycle, and the costs of setting up and operating service networks.

3. The Body Company Landscape is in Turmoil

The body industry is splitting up into specialists and standard producers. Whereas specialists are emerging as an important new target group and sales channel for commercial vehicles manufacturers, the number of standard producers will plunge dramatically. Those that remain will mutate into equipment suppliers for chassis manufacturers.

4. The Used Vehicle Segment is Growing in Importance

In the future, an ability to handle the professional assessment, trade-in, distribution, and marketing of used vehicles will play a crucial strategic role, not only in the exploitation of new markets, but also as an independent source of income requiring its own business design.

5. Continuing Pressure toward Mergers and Cooperations

In the future, rising development expenses, cost advantages in production, and the high costs of the requisite service networks will force commercial vehicles manufacturers to enter further mergers or cooperations.

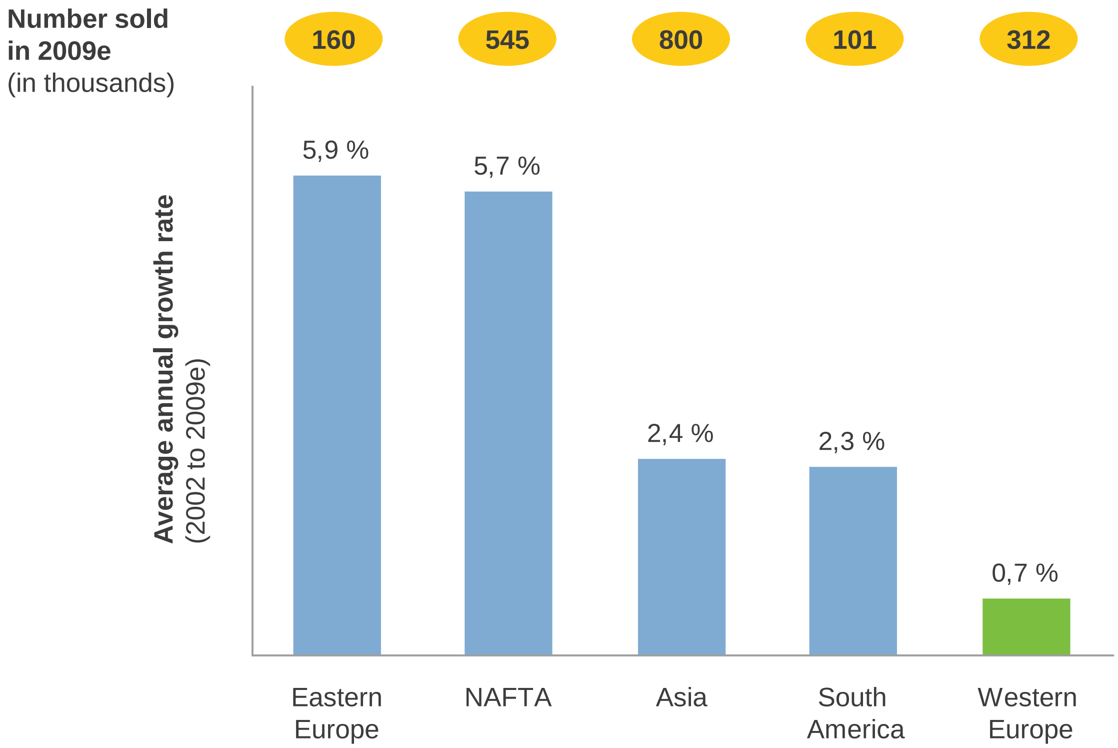
6. The Value Chain is Splitting Wide Open

Up to now, business designs had fixed boundaries between body companies, manufacturers, rental firms, service providers, and customers. Now these boundaries are shifting: outsourcing requests from customers are giving suppliers fresh opportunities for forward integration. The battle for customers will become tougher as suppliers with contrasting business designs find themselves in mutual competition.

Sales Figures for Commercial Vehicles

In 2009, more than 1.9 million commercial vehicles will be sold worldwide. The CV market is stagnating in Western Europe but growing in the emerging markets and NAFTA countries

World Market for Commercial Vehicles
Sales figures for CVs > 6 t, in thousands

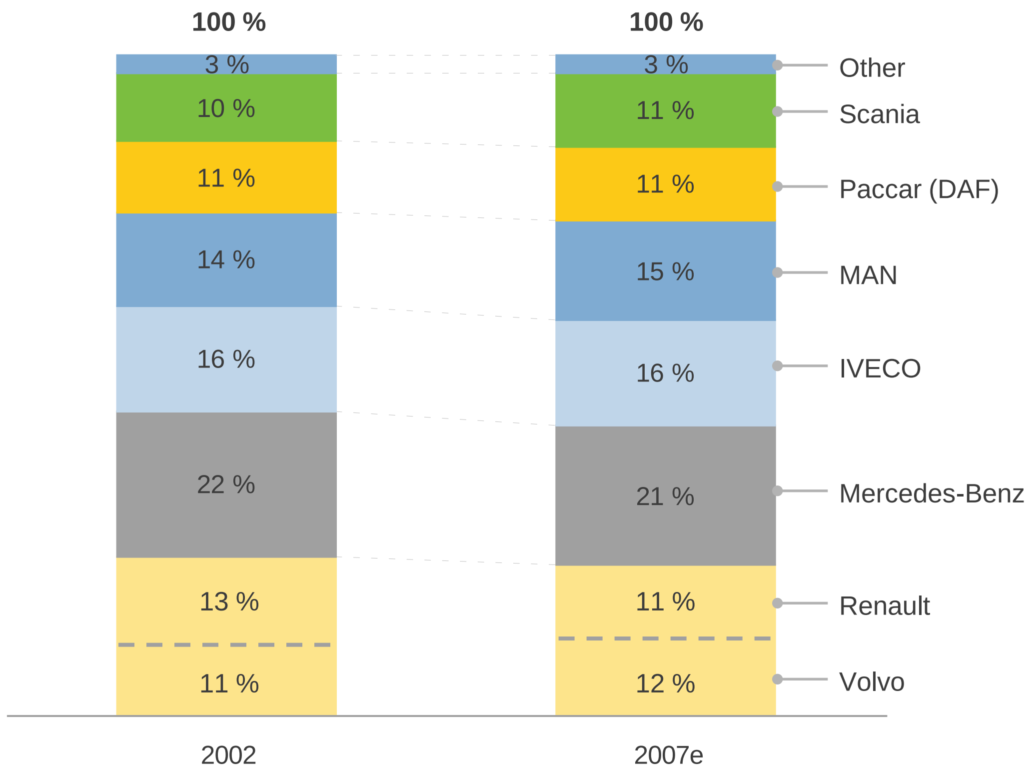


Market Shares

The market shares of CV manufacturers will barely budge over the next few years.

CV Market Shares in Western Europe

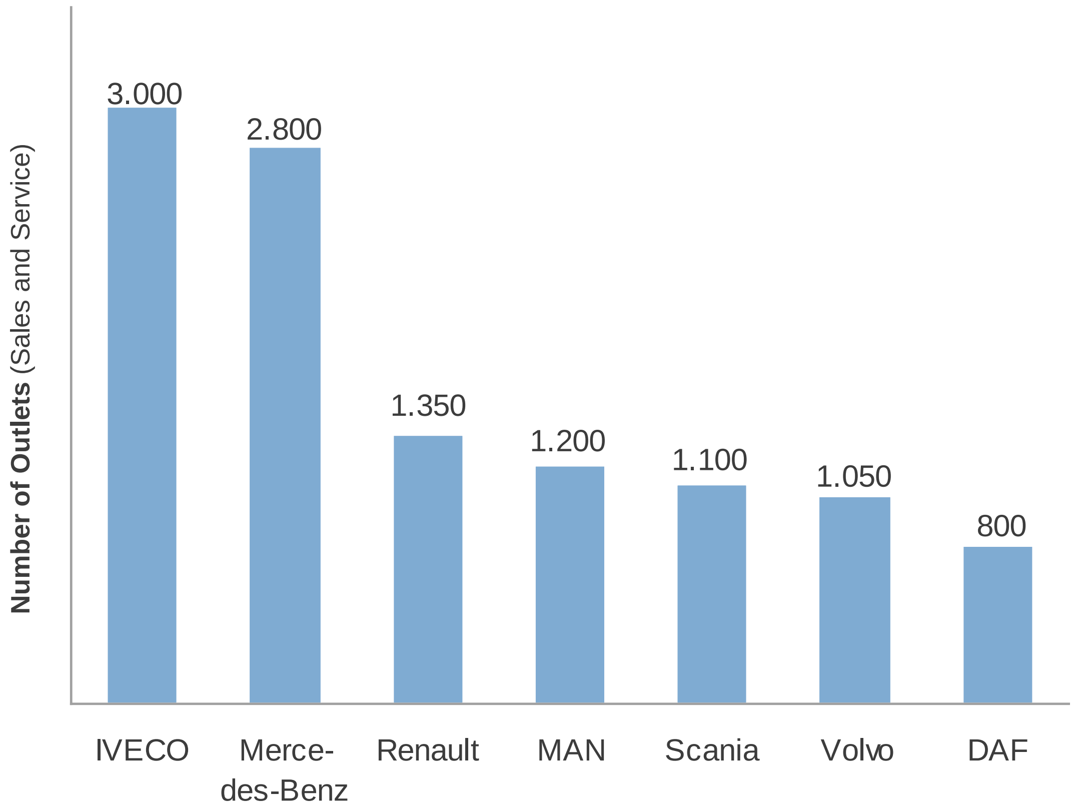
for CVs > 6 t, in percent



Service Networks

Today every European manufacturer has a comprehensive and largely brand-exclusive service network.

Service Networks in Europe



Shifts in the Value Chain

Most CV manufacturers are sizably expanding their percentage of higher-quality services.

Service Market in the CV Sector

Example: IVECO