CHAPTER – 5

OVERVIEW OF GLOBAL AUTOMOTIVE INDUSTRY & CONCEPTUAL FRAMEWORK OF OUTSOURCING
CHAPTER 5

Overview of Global Automotive Industry & General Trend

5.1. Industry Overview

5.1.1. History

The evolution of the automotive industry has been influenced by various innovations in fuels, vehicle components, societal infrastructure, and manufacturing practices, as well as changes in markets, suppliers and business structures. Some historians cite examples as early as the year 1600 of sail-mounted carriages as the first vehicles to be propelled by something other than animals or humans. However, it is believed by most historians that the key starting point for the automobile was the development of the engine. The engine was developed as a result of discovering new energy carrying mediums, such as steam in the 1700s, and new fuels, such as gas and gasoline in the 1800s. Shortly after the invention of the 4-stroke internal combustion gasoline-fueled engine in 1876, the development of the first motor vehicles and establishment of first automotive firms in Europe and America occurred. See Figures 1 and 2 in Appendix A for a timeline of the automotive industry from 1895 to 2000. During the 1890s and early 1900s, developments of other technologies, such as the steering wheel and floor-mounted accelerator, sped up the development of the automotive industry by making vehicles easier to use. Almost simultaneously, in America, the societal infrastructure that would provide fertile ground for the proliferation of automobiles was being set. Driver’s licenses were issued, service stations were opened, and car sales with time payments were instituted. Famous vehicle models such as Ford’s Model T were developed during these times and, by 1906, car designs began abandoning the carriage look and taking on a more “motorage” appearance. During the 1910s, the development of technologies and societal infrastructure continued in addition to new manufacturing practices and business strategies. Traffic lights started appearing in the U.S. and thousands of road signs were posted by B. F.

180 Donald Bradley, Morgan Bruns, Adam Fleming, Jay Ling, Lauren Margolin, Felipe Roman, 2005. “AUTOMOTIVE INDUSTRY ANALYSIS”
Goodrich on over 100,000 miles of U.S. roads. Henry Ford’s famous assembly line was launched in 1913, which allowed vehicles to be mass produced and thus achieved economies of scale. Ford also introduced the concept of using interchangeable and standard parts to further enable the mass production process. Automakers also started to merge with other companies (e.g., GM acquired Chevrolet) and to expand to other markets (e.g., GM of Canada). In the 1920s, the development of infrastructure, adoption of new manufacturing practices, and the merging of companies continued (e.g., Benz and Daimler, Chrysler and Dodge, Ford and Lincoln). In the U.S., the Bureau of Public Roads and the enactment of the Kahn-Wadsworth Bill helped facilitate road-building projects and develop a national road system. In manufacturing, mass production methods became better established, which led to the availability of a wide range of satisfactory cars to the public. While Ford had focused on a single model, GM adopted a new production strategy for providing greater product variety, which helped the company increase their market share by 20% and reduce Ford’s by 24%. In the 1930s, several new vehicle brands were developed (e.g., Ford Mercury, Lincoln Continental, Volkswagen) and trends in vehicle consumer preferences were established that differentiated the American and European market. In the U.S. market, consumers preferred luxurious and powerful cars, whereas in Europe consumers preferred smaller and low-priced cars. Also during this time, GM’s product variety strategy continued to give them a competitive advantage over Ford, allowing GM to continue increasing their market share while Ford kept losing theirs. In the 1940s, during World War II (WWII), automotive factories were used to make military vehicles and weapons, thus halting civilian vehicle production. After WWII, the economies of most European and some Asian-pacific countries, such as Japan, were decimated; this required the development of new production and business strategies such as those of Toyota, which began to develop what is now known as Just in Time (JIT) manufacturing. Most of the first models produced were similar to the pre-war designs since it took some time for the plants to revamp their operations to make new designs and models. In the 1950s and 1960s, more technological innovations, such as fiberglass bodies and higher compression
ratio fuels, allowed vehicle developers to appease the growing consumer interest for vehicle comfort, look, and feel. Car designs were highly influenced by emerging safety and environmental regulations. Vehicle speed limits and front seat belts became standard, in addition to other features such as heating and ventilation equipment. The 1970s were marked by stricter environmental regulations and the oil embargo of the early 70s, which led to the development of low emission vehicle technologies, such as catalytic converters, and a 55-mph nationwide speed limit in the U.S. Foreign cars like the Japanese Honda Civic started appearing in the U.S. market. The Civic was marketed as a fuel efficient and low-emissions vehicle, which given the recent high oil prices and strict environmental regulations made it well-received. Despite the entrance of new competitors into the U.S. market, U.S. automakers underestimated the threat of foreign automakers to their market shares. In the 1980s, the U.S. automotive industry began losing market share to the higher quality, affordable, and fuel efficient cars from Japanese automakers. In response to this market share loss, U.S. automakers began focusing on improving quality by adopting different Japanese manufacturing management philosophies, such as JIT. Although their adoption of JIT and other philosophies helped improve the quality of U.S. vehicles, it did not fully bridge the gap between the quality of U.S. and Japanese cars. This gap remained because U.S. automakers tried applying JIT techniques without a full understanding of the whole Japanese manufacturing system, while Japanese automakers had decades to develop, refine and master their JIT approach. Another significant paradigm of the 1980s was the global nature of vehicle manufacturing. Automakers started assembling vehicles around the world. This trend was accelerated in the 1990s with the construction of overseas facilities and mergers between multinational automakers. This global expansion gave automakers a greater capacity to infiltrate new markets quickly and at lower costs. The increased product offerings in many markets led to consumers having a greater variety of vehicles from which to choose. To this new vehicle buffet was coupled the explosion of the internet, which made vehicle-related information readily accessible to consumers. Internet-informed and empowered consumers now wanted a vehicle that was
“personalizable,” inexpensive, reliable, and quickly obtainable. Consumers desired vehicles that were less harmful to the environment, which led to the introduction of hybrid vehicles by Japanese automakers in the late 1990s. In the current decade, the recent trend of increasing sophistication and empowerment of the consumer has led automakers to identify new and more specialized markets within saturated markets with diverse customer bases, such as that of the U.S. Another trend is to infiltrate new emerging markets such as Southeast Asia and Latin America, which has further motivated the establishment of production facilities overseas and the establishment of global alliances and commercial strategic partnerships with foreign automakers. Of these new markets, China appears to be the most promising.

5.1.2. Buyer and Supplier Power

In the relationship between the automotive industry and its suppliers, the power axis is substantially tipped in the industry’s favor. The automotive industry is comprised of powerful buyers who are generally able to dictate their terms to their suppliers. There are specific characteristics that make members of the automotive industry powerful buyers: (1) there is not a grand proliferation of companies manufacturing automobiles, and the four largest automotive companies in the U.S. have roughly 90% of the value of shipments and value added in the U.S. (see Appendix D); (2) automotive parts (e.g., oil filters, mufflers, belts, etc.) are standardized commodities and these parts are only used on automobiles; and (3) backward integration can and does occur, as seen in summer 2005 when Ford purchased struggling parts maker Visteon. In the relationship between the automotive industry and its ultimate consumers, purchasers of finished vehicles, the power axis is tipped in the consumers’ favor. Consumers wield the greatest power in this relationship due to the fairly standardized nature of the automotive commodity (a vehicle) and the low switching costs associated with selecting from among competing brands. However, the automotive industry remains marginally powerful due to the large customer to producer ratio. The automotive industry is a dynamic place. With the forces above at play, and with history as a
guide, it is safe to say that the automotive industry will continue to change, evolve, and adapt.

5.1.3. Financial Analysis of Major Global Automobile Companies

In this section we investigate ten major companies in the automotive industry to gather a better understanding of the automotive industry's dynamics on a company-by-company basis. For insight into the relative revenues and net incomes for 2004 for each of the companies analyzed, please see Figures 3 and 4 in Appendix A. Additional financial information for each of the companies may also be found in Appendix B.

5.1.3.1. DaimlerChrysler

DaimlerChrysler (DCX) was formed in 1998 in a merger of two of the automotive industry's oldest and most prestigious manufacturers: Daimler-Benz AG and the Chrysler Corporation. This so-called “merger of equals” was the culmination of a long complicated family history that in some sense follows the history of the automobile itself. Because of this prestigious history, DaimlerChrysler enjoys a strong reputation on both sides of the Atlantic. Today, DaimlerChrysler employs a total of 384,723 people in 17 countries. Their products are sold in over 200 countries. DaimlerChrysler is the fourth largest vehicle producer in the world in terms of units sold behind GM, Ford, and Toyota. In 2004, DaimlerChrysler sold 4,000,700 passenger vehicles and 712,200 commercial vehicles. The company is structured into three main automotive groups: the Mercedes Car Group, the Chrysler Group, and the Commercial Vehicles Division. These groups are parents to a total of 12 different brands, including Mercedes-Benz, Dodge, Chrysler, Jeep, the luxury car Maybach, and the compact environmentally friendly smart car. In all, DaimlerChrysler produces approximately 126 vehicle models. DaimlerChrysler has been marginally successful in the United States where the Chrysler Group has recently been the strongest of Detroit's Big 3. In fact, during the third-quarter of 2005, Chrysler was the only Big 3 Company to earn a profit ($379 million for the quarter). This came in spite of a 21% drop in third-quarter earnings by DaimlerChrysler worldwide due to increasing taxes.
However, during this same period, DaimlerChrysler increased operating profit by 38%. Analysts have attributed this odd result to increasing demand for Chrysler and Mercedes products. This increased demand is evidenced in the U.S. market where the Chrysler Group produces four of the 20 top selling passenger vehicle models: the Dodge Ram, the Dodge Caravan, the Jeep Grand Cherokee, and the Jeep Liberty. As a result of this improved third-quarter performance, Chrysler’s U.S. market share has risen to 13.3%. More broadly, the popularity of DaimlerChrysler models can be seen in the steady rise in revenue over the past three years (see Figure 5 in Appendix A). From 2002 to 2004, revenue has increased 22.6% from $157 billion to $192 billion. Because demand for DaimlerChrysler products has remained relatively stable in the face of increasing oil prices, their future looks relatively bright. Growth in demand for passenger vehicles is expected to further slow in North America, Western Europe, and Japan. Therefore, DaimlerChrysler’s future depends upon successful marketing in emerging markets across the globe.

5.1.3.2. Ford

Ford Motor Company (F) was founded in 1903 by automotive and industrial pioneer Henry Ford in Dearborn, Michigan. Being first to implement a moving assembly line for automotive manufacturing, Ford was able to more efficiently mass produce their products than their competitors. In 1908 the Model T was introduced and went on to sell over 15 million vehicles, firmly establishing Ford as the major player in the early automotive industry with 50% market share by the 1920s. The company went public in 1956 and since then has grown to be a significant presence in the global automotive market. The Ford Motor Company product portfolio includes cars, trucks, and SUVs from the following brands: Ford, Lincoln, Mercury, Mazda, Aston-Martin, Jaguar, Volvo, and Land Rover. In addition to its core automotive business, Ford has a finance division, a parts and service division, and they also currently own Hertz Corporation, the largest car rental business in the world. Relative to other massive automotive manufacturers in 2003, Ford was number two domestically and globally (behind GM), in terms of number of vehicles sold. Ford’s outlook is challenging. In the 3rd quarter of 2005, Ford
posted a pre-tax profit loss of over $1.3 billion in their automotive operations, with a $1.1 billion loss in North America. The current losses for 2005 are due to a number of reasons: (1) rising costs of commodities, namely steel and energy, have increased manufacturing costs considerably; (2) ongoing and rising health care costs, particularly ‘legacy’ benefits paid to retirees and their families; (3) bailing out major parts supplier Visteon from bankruptcy; and (4) vehicle sales lagging by 81,000 units compared to the same point in 2004, in spite of unprecedented “Employee Pricing” sales offered during summer 2005. Sales are especially lagging in the profitable SUV and truck markets where demand is dropping due to escalating gasoline prices. This loss is disappointing given the positive trend seen in net income for the past two years (see Figure 6 in Appendix A). The negative net income seen in 2002 was due to the costly safety recall of defective Firestone tires used on numerous Ford and Mercury trucks and SUVs. Ford’s poor performance in 2005 and dark outlook were reflected in the downgrading of their credit ratings by both Standard & Poor and Moody’s to “junk” status in late spring 2005 - from BBB- to BB+ and Baa3 to Ba1, respectively. The volatility of Ford’s stock, in terms of its Beta rating, is in the neighborhood of 1.6 which indicates that investing in their stock has fairly high risk. In the face of poor performance and negative trends, significant steps must be taken in the near future to ensure the long term viability of Ford Motor Company. Elements of company-wide restructuring have been announced and implementation begun. Part of the restructuring involves reducing personnel, mostly from white-collar positions. In more long term restructuring, the company needs to shed over-capacity in manufacturing. Shedding over-capacity involves closing down and consolidating manufacturing facilities. These closures are prevented by agreements made with the United Auto Workers (UAW) through 2007. A key element in Ford’s success is its relationship with the UAW and ability to get concessions from the union. Concessions over healthcare costs, which cost upwards of $2000 per new vehicle sold, and plant consolidations are required for Ford to be leaner, more efficient, and more cost-effective in its business. In addition to organizational restructuring being vital to the future success of Ford, the company realizes the need to reestablish their market
share, particularly in the U.S. domestic market. They have begun attempts to do this with the introduction of many new vehicles to freshen and invigorate their product line. Ford has announced plans to increase its hybrid vehicle production tenfold to 250,000 per year by 2010. This could be viewed as an attempt to position itself as the domestic leader in the rapidly growing hybrid market in the U.S. If the organizational restructuring comes off well and new product offerings are a hit with consumers Ford stands a good chance to see another 100 years as an industry leader.

5.1.3.3. General Motors

After its organization in 1908, General Motors (GM) proceeded to acquire seven companies by the end of 1909. Today, the company’s brand names include many of the beginning acquisitions including Buick, Cadillac, Chevrolet, GMC, Oldsmobile, and Pontiac, as well as newer acquisitions and creations including Holden, Hummer, Opel, Saab, Saturn, and Vauxhall. GM is the largest automobile manufacturer in the world, selling nearly nine million cars in 2004, which equated to a 14.5% global market share.

As of the end of 2004, GM reduced its projected earnings for 2005 by over 50% from previous projections, which reflects its low expectations for the company in the near future. Investors have also lost faith in the future of GM; the current stock price is selling at a fraction of the book value. GM’s debt has been steadily downgraded and stood at BBB- as of the end of 2004 according to Standard & Poor’s ratings.

According to their Letter to Stockholders, GM’s main problems consist of “global overcapacity … falling prices … rapidly escalating healthcare costs … unstable fuel prices … [and] increasing competition.” The effects of these troubles can be seen quantitatively through the ratios provided in Table 1 of Appendix A. GM’s debt ratio illustrates that their overall debt nearly equals their assets; their current ratio shows that they have more liabilities than assets in the upcoming year; and the return on sales and equity are very low in comparison to industry standards. Each of the five ratios places GM among the worst three out of the ten sampled companies. While these ratios
in no way provide a complete measure of a company, they do illustrate that GM is currently struggling to keep up with its competitors.

GM’s main problem is their failure to remain cost-competitive in the global market. To address this, GM has reworked deals with both American and European Union’s which will reduce its cost of labor. To increase revenues, GM is focusing on increasing market share in growing countries such as India and China. They are also offering more hybrids to increase their fuel efficient offerings, which is a fast growing market in America and has been one of the main ways that foreign manufacturers have increased their market share in GM’s primary markets. It will take some time for GM to become profitable again. In the first three quarters of 2005, GM has seen losses continue to grow well past $1 Billion and their credit rating has been reduced to junk status. However, GM still has the largest market share in the world and the capability to become successful again. If GM can reign in escalating costs and offer cost-competitive products, the automobile giant will be in position to once again assert its dominance of the market.

5.1.3.4. Honda

Honda Motor Co. (HMC) was established by Soichiro Honda in 1946. It originally began producing motorcycles in the mid 20th century and began manufacturing automobiles (the Honda Civic) in 1972. After the original Civic’s inception, Honda produced many variants of this highly successful vehicle, such as the four-door sedan, wagons, hatchback, coupe, and more recently the hybrid. Honda currently has two automotive brands (Honda and Acura) and it produces over 20 other vehicle models, such as the Accord, Element, Insight, Odyssey Minivan, Pilot SUV, and Ridgeline Truck, in addition to producing motorcycles and power products. Since Honda began producing automobiles it has been a leader in producing fuel efficient and low emissions vehicles. In 1977 and 1983, Civic models ranked first in U.S. fuel-economy tests. Honda has also introduced hybrid vehicles such as the Insight, Civic, and Accord, in 1999, 2002, and 2004, respectively, with the 2006 Insight being the most fuel efficient car of 2006. Currently, Honda ranks
sixth in sales within the automotive industry. They have overseas plants in over 12 countries including the U.K., Italy, Brazil, Taiwan, Indonesia, Malaysia, Thailand, Nigeria, U.S., and Canada. Honda has been increasing their production capacity worldwide in response to their steady growth in total sales over the last few years. From 2002 to 2003, Honda increased sales by 95,000 units, and from 2003 to 2004, sales increased by 259,000 units. With this growth in sales Honda has seen a commensurate increase in its revenues (see Figure 7 in Appendix A). In China, they saw approximately a 50% increase in sales from the fiscal years of 2003 to 2004, and they expect sales to keep increasing. In the future, Honda has stated that they will keep improving the fuel efficiency of all their vehicles. They will continue to expand their production capacity in Asia, due to the expected increases in demand in those regions. In the U.S., they plan on launching new models targeted to younger people to create a new base of loyal customers. Given Honda’s past record on delivering high quality and fuel efficient vehicles, their strong position in the current market, their strategic direction for the next few years, and the rising costs of fuel worldwide, it is evident that Honda will have a strong presence in the automotive market in the future.

5.1.3.5. Hyundai

Hyundai Motor Co. (HMC) was established in Korea in 1967. The company’s first model (Cotina) was released, in cooperation with Ford Motor Company, in 1968. In 1998, Hyundai acquired a 51% stake in Kia, but has since reduced its share to 37%. In 2004, Hyundai was South Korea’s largest car maker and the world’s seventh largest car maker selling 2.3 million units. Hyundai currently offers about a dozen cars and minivans, as well as trucks, buses, and other commercial vehicles. Some popular entries in their product lineup include the Accent, Sonata, Tucson, Elantra, Santa Fe, and Tiburon, which all earned the title “Best Bet” in Jack Gillis’ The Car Book 2005.

Hyundai’s outlook is on the upswing. Hyundai’s parent company, Hyundai Motor Group, began investing heavily in the quality, design, manufacturing, and long-term research of its vehicles starting in 1998. This investment paid
off in 2004 when Hyundai tied with Honda for initial brand quality in a survey from J.D. Power and Associates. Hyundai’s increase in both quality (named “Best Value Car Award Winner” – Smart Money magazine 2005) and safety (received “Automotive Excellence in Safety Award” – Popular Mechanics 2005) along with its low prices will allow it to continue to grab new market share. Reflecting this trend of low prices and increased market share, in 2004 Hyundai reported a dramatic increase in annual revenues to 50.7 billion dollars and only a small gain in net income to 1.78 billion dollars (see Figure 8 in Appendix A). Hyundai’s growth is fueled by increasing international sales. From January-September 2005, sales in Russia increased 100% and sales in the U.S. increased 10% year-on-year. To meet this new demand, Hyundai has been investing in manufacturing plants in North America, India, China, Turkey and research and development centers in North America, Japan and Europe. In June 2004, Hyundai opened its first plant in the U.S. In 2006, Hyundai plans to start construction on a new production plant in Europe. Counteracting these positive international sales trends, Hyundai has recently run into trouble in its domestic (Korean) plants. In August 2005, the production of 25,683 vehicles was delayed due to a strike by the company’s unionized workers. Later that week, Kia’s workers joined the strike causing Kia to delay the production of 21,273 vehicles. The economic effects of these strikes have yet to be reported. If Hyundai can overcome these recent strikes, the company’s future outlook is promising.

5.1.3.6. Maruti Udyog

A license and Joint Venture agreement was signed between the government of India and Suzuki Motor Company (SMC) in Oct. 1982 to launch Maruti Udyog Limited (MUL). Today, MUL offers 11 models, including the Maruti 800, Omni, premium small car Zen, international brands Alto and WagonR, offroader Gypsy, mid size Esteem, luxury car Baleno, MPV, Versa, Swift, and Luxury SUV the Grand Vitara XL7. MUL’s dominant position in the Indian car market and its ability to satisfy its customers have made it the success it is today (see Figure 9 in Appendix A). MUL has been the leader in the Indian car market for two decades. Today, MUL holds about 50% of the
total Indian market. For a record sixth year in a row, MUL was ranked highest in customer satisfaction, according to the J.D. Power Asia Pacific 2005 India Customer Satisfaction Index Study. In 2004, Business World ranked MUL among the country’s five most respected companies and the country’s most respected automobile company. As the dominant player in the Indian automobile market, MUL is focusing on entering new markets in India to increase market share. MUL recently added service businesses including sale and purchase of pre-owned cars, lease and fleet management service for corporate clients, Maruti Insurance and Maruti Finance. In April, MUL made large investments in a new plant that will produce diesel engines. Once this plant is operational, MUL plans to increase its role in the diesel segment of the market, which now accounts for about one-fifth of the total passenger car market in India. Competition has become fierce in some Indian market segments, especially entry level compact cars. MUL’s major competitor in this market, Hyundai Motor Company, is aggressively expanding its sales and network across India. MUL has reduced the price of the Maruti 800 three times this year to keep this model cheaper than those offered by Hyundai. Even with the planned expansion to new Indian markets, MUL’s future success will depend greatly on how well it can compete with its new international competitors.

5.1.3.7. Nissan

Nissan Motor Co., Ltd. (NSANY), was established in 1933 in Japan, but its roots go back to 1914 when the first Datsun automobile was produced. Nissan first appeared on American shores in 1958 when a Datsun sedan was released on the U.S. market. Nissan furthered its influence on the American market in 1960 when Nissan Motor Corporation, U.S.A. was established in Gardena, California. In 1989, Nissan founded Infiniti, the luxury division of Nissan North America, Inc. The most recent major corporate event, however, came in 1999 with the formation of the Renault-Nissan alliance. While Renault, a French corporation, and Nissan remain independent corporations, “both companies share a single joint strategy of profitable growth and a community of interests.” More specifically, as a result of the alliance, Renault
holds a 44% stake in Nissan, while Nissan owns a 15% stake in Renault. Excluding Renault, Nissan supports two major brands – Nissan and Infiniti, and produces a total of 18 different vehicle models. Nissan’s stated mission is “investment in the future.” Nissan has experienced a substantial recovery over the past six years. Carlos Ghosn became CEO of Nissan in 1999 after leading both Renault and Michelin U.S. through economic turnarounds. Before Ghosn’s arrival, Nissan had experienced seven years of losses. After posting a -$6.456 billion net income in 2000, Nissan has steadily recovered under Ghosn’s leadership such that in 2004 they earned $4.882 billion in net income. Since 2002, revenue has increased approximately 50% (see Figure 10 in Appendix A). Sales have risen 22% over that same period. In 2004, Nissan was able to sell 3,388,000 automobiles. Nissan, including all consolidated subsidiaries, currently employs 123,748 workers in 18 countries on 4 continents.

Nissan’s market share in the U.S. stands at around 6% as of 2004 while, in Japan, Nissan holds 19.3% of the market as of 2005. Along with Toyota, Nissan has recently become one of the most successful Japanese automobile companies in the U.S. The Infiniti brand has regularly been the recipient of industry awards. In 2005, the Infiniti G35 won the Automotive Lease Guide’s (ALG) Residual Value Award given to the vehicle expected to retain the highest percentage of its original value. Also, the G35 was a recipient of Car and Driver’s 10 Best Award. In 2004, AutoWeek named the G35 “America’s Best Coupe”. Two other models, the Q45 and the M, have been given the Insurance Institute for Highway Safety’s (IIHS) highest possible safety rating of “Best Pick.” Nissan is not optimistic about the sales outlook in the U.S. or Chinese markets. Ghosn recently predicted that growth in the U.S. market is at the beginning of the end, and that the sales “bonanza” in China is a thing of the past. In the face of an industry-wide decrease in growth, Nissan’s outlook is not outstanding. However, good management and a strong global presence will serve Nissan well as the competition moves to emerging markets.
5.1.3.8. Shanghai AIC

The Shanghai Automotive Industrial Company (SAIC) Group, representative of the numerous up-and-coming auto manufacturers in Asia, is a government controlled firm that produces passenger cars, tractors, motorcycles, trucks, buses, and automotive parts. SAIC was established in the 1960s, but only started to make a significant impact in the automotive market upon entering into a joint venture with Volkswagen in 1984 to manufacture Santana sedans. In 1997, SAIC expanded further by creating a second major joint venture, this time with General Motors. With approximately 50 plants in the Shanghai area and over 40 joint ventures with global automotive companies, SAIC is now the largest automotive manufacturer in China. SAIC is not publicly traded, but has one subsidiary, an auto parts manufacturer titled Shanghai Automotive Co., Ltd, listed on the Shanghai Stock Exchange. Although SAIC’s origins were small, the joint partnerships with Volkswagen and GM served as a way for SAIC to jumpstart their enterprise in terms of capital, expertise, and designs. By 2000, SAIC’s production capacity had reached 400,000 vehicles and accounted for 45 percent of China’s car market. In 2003, SAIC produced over 600,000 cars just in the joint ventures with VW and GM, a dramatic increase of 57% from 2002. That catapulted SAIC onto FORTUNE’s list of the world’s 500 largest companies at number 461, with revenues in 2003 of US$11.8B and profits of US$689M. However, SAIC has ambitious intents to go beyond the opportunities afforded by these joint ventures. SAIC plans to develop its own brands and to have them on the market as early as 2007, with goals of producing 2 million cars in 2010 and 3 million in 2020. Doing so would make SAIC one of the six largest automotive manufacturers worldwide. To achieve this semi-independence, SAIC has put great emphasis on research and development. Among other things, it acquired intellectual property rights for the Rover 25 and 75 before MG Rover’s collapse and last year purchased Ssangyong, a South Korean maker of sport utility vehicles. This purchase makes SAIC the first Chinese automaker to have a controlling interest in a foreign carmaker, helping achieve two other goals: expanding beyond China.
to enter the global automotive market and getting ahead of its two main local competitors, Dongfeng Motor and First Auto Works. As a goal for its world market, SAIC aims to hit export revenues of US$5B in 2010.

Despite these ambitious goals, the recent past has been fairly tumultuous for SAIC, just as it has been for the entire global automotive market. 2003 was an amazingly prosperous year for SAIC, with production of passenger cars leaping to 612,216 from only 390,508 in 2002 and with an accompanying 37% increase in revenues. But sales slowed in 2004, with revenues gaining only 3%. And in the first four months of 2005, SAIC saw earnings drop by 74%. Yet obviously the market potential in China is huge – as of last year, there were 940 vehicles for every 1,000 drivers in the U.S., 502 in Japan, and only 8 in China. But because of this high market potential and relatively low barriers to entry, competition is fierce and oversupplies a distinct possibility. In addition, attempts by the Chinese government to curb spending by making financing more difficult have reduced sales rates significantly.

To be successful, SAIC will need to adapt it to the markets it intends to penetrate: in China, it will need to transition from the traditional Chinese automotive market which featured lavish passenger cars targeted at government and business officials to the future market of compact sedans and other smaller, cheaper cars targeted at the growing middle class. For international markets, it will need to address challenges related to branding, R&D, design, and marketing, which established international manufacturers have had years to work out. SAIC will also experience some growing pains – it will have to tiptoe through issues of knowledge transfer and intellectual property as it attempts to simultaneously produce Volkswagens, GM cars, and vehicles under its own brand. And SAIC will have to follow through on current plans to list in an upcoming international IPO. If SAIC can endure these challenges, it has immense potential both in China and worldwide.
5.1.3.9. Toyota

Toyota was established as a public company in Japan in 1937. It entered the U.S. market in 1957, but only became successful with the introductions of the Corona in 1965 and the Corolla in 1968. By 1970, Toyota was the world’s fourth-largest carmaker and by 1975 had displaced Volkswagen as the U.S.’s #1 auto importer. Toyota began auto production in the U.S. in 1984 through a joint venture with GM, and launched the successful Lexus line in the U.S. in 1989. Since then, Toyota has continued to grow steadily, becoming the third largest global automotive manufacturer as of 2003, with sales last year of 7.4 million vehicles. Unlike many other large auto manufacturers, Toyota carries only 4 brands: Toyota, Hino, Scion, and Lexus; it also has a majority interest in Daihatsu. Known for their quality and reliability, Toyota cars and light trucks such as the Camry (Best-selling passenger car in America, 2004), Corolla, Lexus LS330, Prius (Motor Trend’s Car of the Year, 2004), Tundra (Motor Trend’s Truck of the Year, 2000), Tacoma (Motor Trend’s Truck of the Year, 2005), 4Runner, and Lexus RX300 (Motor Trend’s SUV of the Year, 1999) have been extremely successful both in the U.S. and abroad. In the last few years, Toyota has been able to ride out the automotive storm, continuing to post impressive results despite the troubles that other companies have seen. In 2003, net income jumped almost 55%, reaching US$10.8B. And in 2004, both revenue and net profit increased slightly (see Figure 11 in Appendix A). Currently, Toyota holds a 6% profit margin, dramatically higher than any of the Big 3. Toyota’s success is based largely on its forward-thinking, innovative management style and its rigorous standards of quality. The Toyota Production System is a much-studied strategy of design and manufacturing which emphasizes streamlining and elimination of waste – giving rise to the “just-in-time” and “lean” manufacturing movements – and continuous error-checking and improvement. In addition, Toyota has repeatedly been ahead of the trend in investing in new technologies. Instead of focusing on reducing labor costs, Toyota has increasingly automated their production facilities. And with the release of the Prius in 1997, Toyota introduced the first mainstream hybrid vehicle, cashing
in on the demand for fuel economy and reduced environmental impact. Like the Prius, the Scion line successfully identified and addressed a new consumer sector, a plan that Toyota will continue to follow. These strategies combine to give Toyota a significant sustainable competitive advantage. The results of this entire are clear: in 2005, Toyota won a record-breaking 10 segment awards in J.D. Power and Associates Initial Quality Study, with Lexus carrying top honors for five years straight. And while 75% of Toyota’s current market is in Japan and North America, it aims to reach markets in 140 countries and regions in the future. With new assembly facilities in Thailand, Indonesia, South Africa and Argentina, Toyota has more than 60 manufacturing facilities in 26 countries. This allows production in geographic proximity to Toyota’s future target markets like Asia and South America. With expansion underway, operations going well, innovative infrastructure and mindset, and well-targeted high quality products, Toyota is excellently positioned for future growth and success.

5.1.3.10. Volkswagen

The Volkswagen Automotive Group was formed in Germany in 1937 based on Ferdinand Porsche’s concept for a “volkswagen,” which literally means a “people’s car.” Today, Volkswagen AG is the largest European car manufacturer. The company is divided into three main groups: the Volkswagen Group, which includes the brands Volkswagen, Škoda, Bentley and Bugatti; the Audi Group, which includes Audi, SEAT, and Lamborghini; and the Commercial Vehicles Group. Together, these groups comprised 11.5% of the 2004 global automobile market. While Volkswagen’s revenues have remained relatively constant, by 2004 its net profit after taxes had fallen to less than one-third of the 2002 level due to increasing costs. See Figure 12 in Appendix A for Volkswagen’s recent net profit history. Although sales in its largest markets of Western Europe and South America have remained constant or strengthened over the past year, sales outside of those markets have dropped. The majority of the losses stem from poor performance within the Volkswagen group and within the North American market. This has resulted in Volkswagen’s global market share falling 0.6% to 11.5%. As profits
and market share are currently at their lowest values in the past five years, Volkswagen has reason to be concerned about the future of the company. Its returns on sales and equity have fallen to 0.8% and 3.0%, respectively. Both rates are worst among the ten companies considered in this report and are approximately half of the next worst ratios. While Volkswagen has blamed an “unfavorable exchange rate” and “weakness in the most important markets” for the latest downturn, the larger problem stems from Volkswagen being unable to provide the best “people’s car” since its competitors are providing similar quality at a reduced price. With this in mind, Volkswagen has begun a restructuring process aimed at making the company and its manufacturing capabilities more conducive to change. It also engaged in a cost-cutting campaign in 2005 including lay-offs and reworking of union deals. While these cuts will provide immediate relief, Volkswagen must find a way to provide a more cost-efficient car to become competitive in the long term. Volkswagen is also attempting to regain its prominence in the Chinese market. After being the first company to pursue that market, Volkswagen held a large share of the government and taxi sectors, which provided a consistent source of income. Due to weakening political ties and loss of market share to newer competition, Volkswagen has made an effort to strengthen joint ventures with Chinese manufacturers Shanghai Automotive Industry Corp. and First Automotive Works. If Volkswagen AG is to reverse its recent decline, the current restructuring must be successful in cutting costs and winning back some of the market share lost. If the North American sector can regain profitability and the rapidly growing Chinese market turns back to Volkswagen, the company will grow in the future.

5.1.4. Summary

Taken as a whole, the individual company analyses in the preceding section lead to several general conclusions about the automotive industry. It is apparent that today’s successful companies share many common business strategies and visions. The entire industry is following several clear trends that will guide the evolution of the automotive industry in the near future. A discussion of these attributes and trends follows.
5.1.4.1. Attributes of Successful Companies

Today’s successful automobile companies possess at least some of the following attributes: production efficiency, well-planned cost structures, manageable size, distributed management of brands, attention to underserved markets, focused strategy, and well-respected brands and products. In this section, we will address each of these attributes individually.

Production efficiency has played a significant role in making Toyota the most successful of today’s automobile manufacturers. Toyota has continually sought to improve efficiency through a number of innovative operational strategies such as the JIT paradigm and the Total Quality Management (TQM) view of design and production. In addition to innovative business strategies, Toyota has moved towards fully automated production facilities, resulting in both decreased labor costs as well as faster production times.

It is interesting to note that the automotive industry’s most productive companies in terms of revenue are also some of its least profitable (see Figures 3 and 4 in Appendix A). This can be attributed to the lack of well-planned cost structures within the industry’s largest producers. High costs can partly be attributed to inefficient production and distribution practices, but increasing health care costs are also a significant drain on the Big 3. In general, the companies without strong labor unions have more flexible cost structures in addition to having lower overall labor costs.

Manageable size is obviously not an attribute of today’s struggling auto manufacturers. GM and Ford lead the market in terms of vehicle production (15 million units and 8 million units in 2004, respectively), but in 2004, they ran two of the lowest operating margins in the industry (both under 2%). This is partly due to poor management and partly due to inertia—it is much more difficult for sweeping changes to filter through the atrophied bureaucracy of an older, well-established organization than through the relatively younger, more flexible foreign companies. Distributed management of brands seems to positively influence the prestige and marketing success of large, conglomerate corporations. This is especially relevant in today’s mature
markets where numerous older brand names have repeatedly joined forces under consolidated central managements. For example, the Chrysler Group is better able to manage and market Dodge products in the U.S. from Detroit than DaimlerChrysler central management would be able to do from Stuttgart; local management better understands both the customer and the brand.

In addition to targeting market segments by locale, identification of and focused attention to underserved markets have helped smaller producers wedge their way into a larger market share. Honda, for example, is not able to compete with Mercedes in the high-end luxury sedan market due to Mercedes’ brand name and prestige. Honda is not able to compete with Ford or GM in the pickup truck market because of their consumers’ loyalty. However, recognizing these limitations, Honda has instead focused their efforts on producing reliable, relatively inexpensive sedans. Today, there are also two clear examples of the effectiveness of identifying and exploiting niche markets. Companies such as Toyota and Honda have established an upper hand on the Big 3 manufacturers by being the first to develop hybrid vehicles.

Customizable products such as Toyota’s Scion line or DaimlerChrysler’s Smart Car similarly appear to be indicative of an emerging market niche. Focused strategy seems to be an essential principle of management in all industries, but its demonstration is especially apparent in the automotive industry. While management at Toyota has been radical in their commitment to production efficiency, larger producers such as GM and Ford have been left behind with their attempts at moderation. JIT management, for example, cannot be successful when done halfway. Toyota’s strategy which focuses on responsiveness and consumer needs has proven successful, whereas companies such as GM and Ford who have not invested as heavily in either one have been considerably less successful.

Finally, since automobiles are expensive long-term consumer investments, it is necessary that automotive companies produce well-respected brands and products. Brand loyalty takes time to build, but it can be done as evidenced by the successes of Toyota, Honda, and Nissan in the
U.S. market. These companies were virtually non-existent in the U.S. before the 1980s, whereas now their products are ubiquitous on U.S. highways. DaimlerChrysler attributes much of their relatively consistent performance to the fact that they have established a tradition of quality brands such as Dodge and Mercedes and have thus achieved sustained customer satisfaction.

5.1.4.2. Changing Trends

Aside from specific company attributes, it is also possible to identify some general trends in the automotive industry. Studying these trends helps predict where the industry is headed and how it will evolve to meet new challenges. These trends will be useful in identifying which companies will likely be successful and how they will achieve success. In what follows, we will address the following trends individually: international expansion, conglomeration in mature markets, and distributed competition in new markets, increased environmental regulation, increased energy constraints, and increased operational efficiency.

International expansion has the potential to be the most lucrative growth sector in the automotive industry. In the U.S., there are 765 cars per 1000 people; in Japan, 543; and in the United Kingdom, 426. In contrast, Brazil has 81, Indonesia 21, India 12; and China only 10; these unsaturated markets provide potential for phenomenal growth. In the past several years, China has been the focus of this international expansion. In 2003, 4.44 million cars were sold in China, up from 2.1 million in 2001. However, it appears as though growth in the Chinese auto market has currently slowed considerably. Whereas growth was at 34% in 2003, the growth expectation for 2005 is down to 12% – still considerably higher than Detroit. It remains to be seen whether this growth will spread to South America, Africa, India, and other emerging markets. It is also uncertain as to whether these markets will be captured by local companies, by one or several of the large, multinational automotive corporations, or by joint ventures between the two.

Conglomeration in mature markets and distributed competition in new markets is a remarkable but obvious trend in the automotive industry in recent
years. The 1990s saw a spate of mergers among American, European, and Japanese automotive companies. Since 1989, Ford has bought Jaguar, Aston Martin, Land Rover, and Volvo; Daimler-Benz AG and the Chrysler Corporation merged in 1998; and Nissan and Renault formed a strategic alliance in 1999. GM and Volkswagen have also taken over a number of other smaller companies. Comparatively, emerging markets such as China and India have seen a somewhat contrary trend. China, for example, has over 120 companies that make passenger cars. This results in distributed competition in new markets, with the large international firms competing not only with each other but also with the numerous smaller, local companies. This diversity in the young markets parallels the early years of the American automotive corporate landscape; it is likely that the trend towards conglomeration seen in mature markets will spread to the emerging international markets over time.

Two general trends that almost certainly will not change are increased environmental regulation and increased energy constraints. While the U.S. government is considerably more lax than its EU counterparts, the trends definitely point towards tighter emissions controls in all developed markets and, ultimately, in today’s emerging markets such as China and India. Besides governmental regulation, auto manufacturers are becoming increasingly affected by a perceived increase in fuel costs. A recent study by the United States Geological Survey (USGS) has predicted that crude oil production will peak sometime between 2026 and 2047, which means that energy constraints will play an increasingly important role in the automotive industry. This fact has many automotive companies developing hybrid drive trains and looking for alternative energy sources to power their vehicles in the near future. As in many sectors, increasing operational efficiency of automotive design, production, and distribution is becoming one of the most important factors in establishing a competitive advantage. Movement towards “real-time” enterprise is increasing, with cycle times becoming shorter and shorter. Table 2 of Appendix A shows, for example, the average amount of time that each company spends fabricating a single vehicle. In almost all
cases, this time has been reduced since last year. These increasingly short turnarounds result in reduced customer lead-time and increased efficiency and productivity for the manufacturer. Emphasis on JIT production and digital information management along with flexible manufacturing lines and supply chains will reduce over-capacity production and will eventually allow customized automobiles to be fabricated and delivered within days or weeks.

5.1.5. The Future of Global Automotive Industry

Given these general industry trends and the attributes related to corporate success, the previous analyses of individual companies can be compared and evaluated for future success. In this section, we identify which companies will become leaders in the automotive industry over the next five years. Four well-established, Euro-American companies were considered in this report: DaimlerChrysler, Ford, General Motors, and Volkswagen. Of these, DaimlerChrysler seems to be holding up best. Its revenues have steadily increased over recent years and demand for its vehicles has also been on the rise. It is also focusing on expanding into emerging markets worldwide. These positive aspects suggest that DaimlerChrysler is in a good position for future success. Volkswagen, on the other hand, will have a rough time over the next few years. Achievement of its stated goal of creating the ‘people’s car’ is being prevented by other companies offering similar quality at a lower price. Even worse off are Ford and General Motors, which will struggle with the negative repercussions of their age and size. Legacy systems, aging workforces, and outdated corporate, production, and distribution structures will prevent them from achieving significant success in the next few years. Honda, Hyundai, Nissan, and Toyota are four Asian companies with international market reach. Of these companies, Toyota stands out positioned on an excellent trajectory for the near future. As a relatively young company, it has been able to create efficient development and production practices as it grows, thus reducing costs and increasing productivity and profitability. A focus on innovation and forward thinking has brought Toyota into the lead in areas such as hybrid technology and automation of manufacturing facilities. Because of the high design and
manufacturing standards within Toyota, its vehicles are synonymous with quality and its brand image is highly regarded worldwide. Toyota has taken the risk of leading the automotive industry into uncharted waters and, as a result, will be rewarded with dramatic success. Honda, while not as revolutionary or trend-setting as Toyota, has presented steady, reliable growth. Attention to defining new markets and tailoring of product lines with an eye to market segment demands and environmental restrictions have Honda well on the way to continued success in the near future. Honda exemplifies the concept that big is not necessarily better; it remains more profitable than any of the Big 3 while posting revenues less than half those of the Detroit companies. Nissan and Hyundai, while not enjoying the stability of Toyota or Honda, will most likely post acceptable performance in the coming years. Nissan’s product quality and history is comparable to the other Asian companies, but it has suffered from a tumultuous past. Nissan’s new management has recorded excellent improvements, but will need to implement new strategies in order to raise it to the next level. Hyundai has been on an upswing and is actively pursuing international expansion, which should allow it to take advantage of new and growing markets. Maruti Udyog and Shanghai Automotive Industrial Company both remain in a somewhat precarious situation due to their focus on only the Indian and Chinese markets, respectively. As larger international companies begin to enter those markets, fierce competition will put increasing pressure on these local companies. Changes in those markets, such as the recent downturn in China’s sales, could be disastrous for these companies, which lack geographical diversification. If they can survive, there is much opportunity for growth—although it will probably take more than five years before they can achieve this expansion and stabilization.

Whether or not the future plays out according to these estimations will depend on factors both internal and external to each company. Management decisions will define how the companies are positioned within the industry and how they pursue new opportunities; fluctuations in emerging markets, global economic trends, and changing customer demand will challenge companies
to respond in new ways. Regardless, many of the companies will face major turning points in their corporate existence over the next five years; the near future will almost surely be a defining period for the automotive industry.

5.2. A BRIEF BACKGROUND OF AUTOMOTIVE INDUSTRY IN IRAN

Introduction

Automobile industry is of high importance in industrial structure of countries. In assay that it is known as driving force of industrial sector because it is the basis for dissemination of new technology and it can absorb and empty the latest scientific and technological innovations. This industry is a basic industry which is highly influential in economic foundations of a society and because of the great number of its consumers always receives high attention.

When researchers study the history of industrialization in every country, it can be seen that this industry is in the midst of their economic changes and the evolutions. This industry can mobilize the other industries and sectors and can move them and make them to grow, because of its many subsequent and antecedent links.

The first motor can which entered Iran was a For automobile which was imported to the country in the early 20th century by the Order of Mozafaraldin Shah of Qajar and purchased from Belgium. But multiple imports of automobile to Iran the commenced from 1921. The issue of manufacturing and assembly of motor car in the country started from 1957, which can be said that manufacturing and assembly of car in the country has a history of 50 years old, while Carle Benz from Germany, in 1885, with invention of internal combustion engine has founded this industry. With establishment of Iran – Khoder (Iran National ) in 1963, the automobile industry was introduced seriously Iran – Kahodso evolutionized the automobile industry in the country, by offering motor cars to the market. Then gradually some other car manufacturing companies were founded and manufacturing and supply of
automobiles grew, though all of them manufactured the motor cars by assembling the parts.

After the Islamic Revolution in Iran during the Iraq-Iran war the economy of Iran damaged greatly, automobile manufacturing decreased greatly. Until 1993, at this time this industry entered a new era. Designing and manufacturing automobiles according to the international standards, the variety and quality of cars, following some policies to decrease manufacturing the some pollutant cars, led to great evolutions in automobile industry.

By joining the automobile industry to stock market and modification of manufacturing and technological structure, this industry is the most revenue generating and the most influential in the country and development in this industry have affected the economic and industrial development of the country. At the present time automobile industry is a second active industry in the country after oil and gas industry. According to the statistics regarding Iran’s automobile industry it can be said that his industry, has passed some stages, but the important issue here which played an influential role in production and distribution of automobile in the country and still it is very important is the issue of foreign exchange and cash in this industry historical eras of automobile industry is distinguishable according to this key variable.

Automobile industry in Iran is a monoplastic Industry and a non competitive environment is dominant in this industry, but with the changes in International structures, the automobile industry in Iran cannot further fall behind these evolutions. The attempts by automobile makers in order to increased production and enhance quality and variety of products and the decrease in import duty to 90% confirms the issue Iran producing more than 46% of automobile in the region is the greatest automobile maker in middle east and neighboring countries. In the past decade was witnessed an increased production in this industry which during the year 1998 to 2008 the production rate increased to 445% some sources stated that Iran will be the fourteenth grates automobile producers in the world until 2012.
In the year 2008, the Iranian automobile industry witnessed the production of 1,146,269 automobiles. Such an increase is very vital for Iran because more than 25% of the transportation fleet in Iran have the age of over 20 years. Most of the produced automobiles are motor cars which are highly in demand. The high demand of motor cars in Iran is because of increase in population, young population and increase in women participation in society. On the whole, the country’s automobile industry possesses some features such as; monopolistic market, low quality products and high prices, existence of market growth potentials, increase in number of automakers, increase in import, increase in variety of motor cars. The main problems which Iranian automobile industry is facing at present are; low quality, low level of lack of managerial and communication system in the history, low efficiency of employee and workers in this industry, etc.

5.2.1. Role of Iranian Government in Automobile Industry

The governments in each regime naturally play three role of regulatory, cognitive and normative. Governments protect different economic sectors through reducing tax, tax rebates, by exerting custom tariffs, granting loans and other regulatory plans. Among the most typical approaches to promote the automobile industry in the world are financial support and exerting tariff barriers. We can also protect those sectors which lacks enough capital and support of market institutions by preferential protections and supports, in order to enable them to gain advantage to compete with other countries.

Plans which concentrate on distribution of knowledge of management and technical skills are in order to reinforce the cognitive foundations; this issue will increase the capabilities of domestic industries. Investment in R & D, training programs, consulting services, are among the plans which lead to more understanding of the condition of the industries for stake holders.

Ultimately, the programs related to enhancing the society’s attitude toward industry can influence the normative environment of a country; hence increase people’s motivation to invest in the industry. Experts argue that the

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cognitive foundations are the most difficult section of Economic Environment which should change in order to make changes and developments in the industry. By investigating on the projections provided to the country’s automobile industry, we recognize that governments have played only their regulatory roles, and in its incomplete form, temporary, causeless, non-strategic and with no specific plan, where as the other two key roles of governments are of high importance. In the following part, the protection and support provided to automobile industry will be addressed.

Support policies, itself forms a development model with special features which follow a specific goal. In other word, the industrial and economic system of each country is an inseparable whole which operates systematically and deliberately destruction of any field in the industrial system of a country may be the forefront of destruction of the related industrial and commercial sectors and consequently may lead to destruction of a part of industrial system of a country.

Support policies are responsible for these preventive roles. However not every support is compatible. The important features which a good support policy (model) can be passed will be defined by answering to the following questions.

1. Why support is necessary?

2. What is the main objective of support policy?

3. How can you identify the industries which need support?

4. What are the support tools?

5. How can these support tools be used properly?

6. To what extent should the industries be supported?

7. How long the support should be continued?
Yet, we should consider that the external situation and developmental environment of a society are among the most important and key success elements of each support policy.

By primary review of the performance of giant automobile companies in the world, we can see that these industries have enjoyed the support and protection of their government in the early stage of their operation and even long after their start up. This protection and support continued until it is felt that they do not need support and they can participate and compete in domestic and international markets on their own. Best examples of this issue are Japan and South Korea.

By reviewing the past and present condition of automobile industry in Iran. Contrary to what have stated earlier, the automobile industry in Iran was not based on the model of substituting import in industrial development.

According to theoretical model of import substitution, for being automaker, it is required to pass some steps which are as follows. In the beginning cars will be imported to create demand in domestic market, in the next step the assembly industry should be set up and next steps should be realized according the following items;

- Establishing subsidiary industries such as; tire industry and glass industry.
- Establishing industries to produce car engines.
- Establishing industries in machineries and parts Manufacturing.
- Establishing rolled steel industries.

In the first stage, the import of foreign cars to create demand has been done properly, in the next stage Iran established a assembly industry and pursued this plan for a long time well, but from this stage till then, what has really happened is, instead of moving in depth and doing backward vertical integration and utilizing subsidiary link for importing complementary industries, they moved in surface and extended the assembly units. That means after assembling Peikan, Jian, Renault, Aria, Ahahin, Cheverolet, and no other
activities have been done in the year of 1970’s industrialization was one of the main objectives of government policies in Iran. The import substitution strategy and protection tools was focused and the justifications to employ this method was enough. Particularly in producing cars domestically which the growth and survival of the companies were not feasible without taking supportive policies for their import of main parts, dependency to foreign raw materials, small scale production, paying royalties, and lack of enough experience comparing to foreign cars, the cost of production was very high.

Government supported the companies in two forms; first by granting direct and indirect aids and second by motivating and aiding private companies by granting loans and credits. However the government aids was not in order and it was not based on a specific model.

These aids were not conducted within a set of systematic measures, to develop technologically neither the ground nor integrated structure for these policies have been provided, nor the support system of commerce had a developmental relationship with technological systems and automobile industry. Secondly the main objectives of the ongoing plans were not definite. Finally soon the government chose another supportive approach which guaranteed the benefit for itself and it was not industry oriented support. The new policies confined to ban an import of public transportation vehicles (bus, minibus, etc) and customs protections. By employing this policy the government’s revenue increased. The customs protection policies continued without considering the necessity of making general changes in the policies and establishing a competitive market for enhancing the quality of automobiles.

After the Islamic Revolution, this issue was escalated for some reasons. The country’s special problem during war time, prioritizing the needs based on the foreign exchange revenues and the manner of its allocation, existence of multiple decision making centres and etc leads to uncoordinated and hastily decisions. Particularly during recent years, different Bylans and
regulations have been reported by different organizations and have changed in a short time.

Calendar of changes in supportive policies regarding automobile industry after Islamic revolution;

- In 1979, import of any type of motor car was banned.
- In 1983, according to a bill by Council of ministers, import of car was liberated under special regulations.
- In 1984, the Trading Profit for import of motor cars was increased.
- In 1985, according to decision of council of ministers, import of car under special regulation (bill of 1983) was cancelled.
- In 1986, the Trading Profit for import of motor cars was increased again.
- In 1990, the import of car was liberated again under special conditions.
- In 1991, the import of car was banned, again in August 1991 the import of car was liberalized by a parliament of Islamic Republic of Iran under special regulations.
- In October 1991, again special regulations were determined for import of cars that import of four models of cars which had Agencies in Iran, including Peguet 405, Mitsubishi (Galant, Lancer, Pajero) Volvo (manufactured in Netherland, 400 series), Subavo Call models) were liberated. According to this Bill, import of other cars which had no agencies in Iran was remained free until autumn 1991 and after that these cars were not allowed to dispatched from Iranians customs.
- In second half of 1993, regarding import of car, 9 contrastive circulars were passed by, Bank officials, ministry of commerce and Iranian customs.
- In 1994, by passing the Vehicle Act, banned the import of any motor car and cancelled the prior exceptions.
- In 2005, import tariffs of cars, decreased up to 90%.
- In October 2008, the import tariffs of cars increased 70% and 1 old cars should be dismantled for import of car which consumes 6 liters per
700 and dismantling 2 old cars for import of cars which consumes 6-10 liters per 700 and 3 for import of car which consumes 70 liter and above were obligatory.

On the whole by reviewing the Acts, bills and Ciralers passed with regard to automobile industry, it can be stated that there was intense protection from automobile industry after Islamic Revolution in Iran.

On one hand, there is a ban of import of automobile and on the other hand there is a very high tan on import, while these scattered and temporary supports have turned the support to its opposite function.

The domestic manufactures, were only think about the profit minimization because of the high profit margin in domestic markets and they have neglected the modern technologies at present, the Iranian automobile industry past 50 years of its activity while the main method production is assembling the parts.

By reviewing the plans conducted in other countries, we can easily find out situation in the field of strategic management. In the following paragraph we will take a look at the policies employed by Government of Australia in automobile industry; government of Australia have done macro planning and policy – making for enhancing and developing the automobile industry in this country. The outcome of these attempts lead of offering solutions which develops the growth of automobile industries and subsidiary industries until the year 2005. Among these plans we can mention the following items.

1. Attempts to sign free –trade bilateral agreements.

2. Attempts of Australian government for further co-operation with the members of ASEAN, New Zealand and Australia.

3. Agreement for petrol consumption of 6.8 liters in 700 Km for the year 2010 and 6.3 liters in 700 Km for the year 2010.

5. Co-ordination of Australian automobile design with UNECE standards.

A plan has been conducted for after 2005, and according to that the Australian government is intended to flourish the Australian automobile industry with its purposeful program.

Australia has decreased its customs tariffs with a progressive plan. This issue has been done at 57% customs tariffs in 1984 and continued with 2.5% decrease per year from 1990 till reaching 15% in the year 2000. ACIS (The Automotive Competitiveness and Investment Scheme) established in Australia in 2001 with aim of creation of innovation and motivating competitive investment and it has designed its economic plans until 2010.

The ACTS motor vehicles producer research and developments D & MVPR is also created for a 5 year plan of 2005 till 2010. This scheme hopes of increase and grow the R&D of Australia automaker with the budget of 150 million dollars. All of the Australian automakers have participated in ACIS project can take part in this project also.

In this turbulent era and in such a condition where the survival of even the giant players are at risk, a print is certain; All of the players in this industry, including; automakers, suppliers and sales agencies will employ offensive structural reconstruction plans for coordinating and integrating with new facts. It is obvious that the winners are those who manage the economic recession period successfully, control cash and eliminate the unnecessary expenditures. At the same time auto makers should prepare themselves for recovery which is expected to start from 2010. Accordingly, continuous investment in new product development and creating new capabilities are necessary issues. Meanwhile successful pioneers of these industry will continuously seek new ways to increase their revenues and protecting their position in automobile industry. Currently, companies in Iran’s automobile industry that are registered in stock market can be divided into two categories namely:

- Automobile manufactory companies in appendix F and
- Companies manufacturing auto parts as shown in appendix G.
IranKhodro Diesel is one of the oldest companies in automobile industry. By looking to the table we can see that the majority of the companies are very old in stock market, the companies’ active in the industry can be divided into; auto manufacturing and auto part manufacturing companies.

5.2.2. Analysis of Financial Ratios of the Companies under the categories of auto manufacture and auto-part manufacture:

5.2.2.1. Current Ratio (Auto Manufacturer)

Current Ratio shows the proportion of each Rial of current debt to the amount of current asset in a company, which indicates to what extent creditors are secured. But this is not true in all cases and the combination of current asset is very influential in financial analysis because of the amounts calculated in the accounts.

Most of the companies in this category possess a current ratio of below one which indicates that the current assets are only enough to cover the current debts, which shows the policy of using debts in most of these companies. Among the companies of this category, Pars Khodro and Iran Khodro Diesel have acted proportionate to the industry.

The current Ratio is equal to 1 for Saipa, which shows the current assets of the company will only cover the current debts. Iran Khodro possesss the lowest current ratio among the companies in this category, which can be due to the policy of the company to increase production and stocking in warehouses.

5.2.2.2. Current Ratio (Auto parts Manufacturer)

Current Ratio in most of the companies in this category is above 1, the average of this ratio in this category is 7.25 which the tractor steel works, sharg automobile electric, Zamyad, Automobile parts, Saipa Azin, are close to this number.
5.2.2.3. Acid Ratio (Auto Manufacturer)

Acid Ratio is one of the most useful ratios. This ratio indicates the proportion of the current assets which by value are more stable and will not decrease in their value and how this part of the current assets will cover the short term creditors. Among the companies in this category, Iran Khodao company possesses the lowest amount in Acid Ratio, which is due to the increase of the company’s current debts and increase in stock? Other companies in this category possesses a acid ratio amount near 60 the average of the industry i.e., 0.62. Rena investment Co possesses acid ratio of above one, but if is Better to compare this company in other parts with other companies.

5.2.2.4. Acid Ratio (Auto – parts Manufactures)

The average of this ratio in the industry is 0.65 and approximately most of the companies are close to this amount.

5.2.2.5. Total Assets Turnover Ratio (Auto Manufacturers)

This is a measure of firm’s efficiency in utilizing its assets. It indicates how many times the assets were turned over in a period and there by generated sales. If asset turnover is high, the company is managing its assets efficiently.

Asset Turnover is very high for Saipa and if is far above the average for industry which is 0.48. By observing the trend of this ratio in Saipa company, it is clear that this ratio has an increasing trend during recent years, in a way that this ratio has increased from 0.56 in 2000 to 1.24 in first half of 207. Increase in the volume of the company’s activities. The opposite of Saipa company, is Bahman Group which possessss the lowest value in this ratio. The trend of this ratio in Bahman Group indicates decrease of this ratio since 2002, which decreased from 0.55 to 0.1 in first half of 2007, this issue indicates that the increase of assets in this company is not connected with increase of sales. Other companies in this category possess a ratio close to the average of the industry.
5.2.2.6. Total Asset Turnover (Auto parts manufacturer)

Axle manufacturers possess high asset turnover among the companies in this category, however by analyzing this trend of this ratio in this company, we can find out that this ratio has had a decreasing trend since the year 2003, in a way that it decreased from 2.06 in 2003 to 7.62 in the first nine months of 2007. According to nine months financial reports, automobile parts companies possess the lowest value among these companies. The noticeable point here is that the automobile parts company weakly covers its revenues in the in the first nine months of the year. However by analyzing the past reports of this company, we can see that this matter has happened in previous years also, but the company covered of its revenues in the last 3 months of the year. Therefore the above mentioned ratio is 0.41 based on the information issued by the general meeting in 2006 and has been increasing from 2002 until 2006 and increased from 0.13 to 0.41, which indicates the increase in activities of this company.

The average amount of this ratio for the category is 0.73 and the automobile electric Company Zamyad, Saipa Azia, Casting industries, Tractor Casting Company, Mehrkam Pars Co Automobile Axle Co. are close to this value.

5.2.2.7. Total Debt to Asset Ratio (Auto Manufacturer)

This ratio indicates the type of capital structure each company utilizes. By observing the present companies in the industry, it can be understand easily that the capital structure of most of these companies is based on loan and borrowings. It means most of these companies use debts for financial requirements rather than using equity. This issue can be understood from the marginal increase of the automobile manufactures capital.

This ratio is sued to determine the financial risk of the companies and it is considered by financial institutions in granting loan to companies.

Saipa Diesel company, poses the highest amount of this ratio among these companies and this ratio has been increasing from 2001 to 2006, it
increased from 0.87 in 2001 to 0.93 in 2006. This happened in a situation where the company has increased its capital 4 times during 2001 to 2006 and increased its capital from 36,900 R/s to 600,000 R/s.

The average of this ratio in industry is 0.71 which tractor Engine manufactures is close to it.

5.2.2.8. Total Debt to Asset Ratio (Auto parts manufacturers)

Among auto parts manufacturers the Endamin Shockabasorber company possesses the highest ratio and Automobile Axle company possesses the lowest ratio. This ratio has been stable in Endamin Shockabasorber company during recent years and in this company there has been no increase in capital since 2002.

In Automobile Axle Company this ratio has been decreasing which is due to the simultaneous increase of the capital and debt in this company. The average of this ratio in this category is 0.65, which Niroo Mohareke, Mehrakampars, Iran Carburetor, Kharar Spring Manufacturing, Zamyad and Iran Radiator are closer to this amount.

5.2.2.9. Profit Management (Auto Manufacturers)

This ratio shows the profitability of sales for each Rial. Profit margin ratio, is the result of 3 factors of

1. Sales volume
2. Pricing policy
3. Expenditure Structure.

Bahman Group possesses the highest profit margin among the companies. In this category, which is due to operational revenues of the company, consequently the operational profit of the company is 39%. The other reason is the identification of non-operational profits of the subsidiary companies which caused the net profit margin of the company is even more the operational profit of the company.
Saipa Diesel Company, possess the lowest profit margin among the companies in this category. The operational profit margin of this company is 17.6% but due to the high financial expenditure which is 0.34 of sales, the net profit margin of the company is very low, which is 2.28. Profit margin of Saipa company is far better than Iran Khodo Company, while the sales of Iran Khodao is considerably more than Saipa. But Saipa possess higher profit margin comparing to Iran Khodao due to lower financial costs and identification of non-operational profit of its subsidiary companies. However the operational profit margin of Saipa is only 2% more than Iran Khodao.

The average profit margin of auto manufactures is 18%.

5.2.2.10. Profit Management (Auto parts manufacturers)

Iran Break pad company possesses the highest profit margin among the auto parts manufactures.

The reason is the low percentage of end cost to sales the companies in this category and lower financial expenses comparing to other companies. However the profit margin trend has been decreasing during past 6 years.

The lowest profit margin belongs to Automobile Post Company, which possesses negative profit margin. But as stated before this company covers most of its revenues in the last 3 months of the year. While the number reported belongs to the first 9 months report of the company by observing to the past reads of the company and according to 12 months reports it is obvious that the profit margin of the company is very high and it is 90% which is due to the profits generated by the company’s investments and low financial expenditures. However in previous years and midterm information, the profit margin of the company is negative.

The Average profit margin of auto – parts manufactures is 70% which is lower that the profit margin of auto manufacturers. The Iran Tractor Manufacturing Casting Co., Iran Tractor Manufacturing Steel Work, Zar spring manufacturing co. is close to this average.
5.2.2.11. EPS Trend (Auto Manufacturers)

On the whole, the EPS trend of auto manufactures is a decreasing trend. But its fluctuation in EPS of some companies such as Saipa has been more and in Tractor Engine Manufacture co has been less. Apart from an increase in auto manufactures revenue such as; Saipa and Iran Khodao co, generally the increase in cost, distribution and sales expenditures and financial expenditures have led to decrease in profit per share of these companies.

5.2.2.12 EPS Trend (Auto parts manufacturers)

A decreasing EPS trend is also true among the companies in this category. Niro Mohareke Co., Iran Break Pad Co., Tractor manufacturers steel work Co., Irna automobile Electric Co, and Tractor manufacturers casting company have had a stable EPS trend.

Finally, it can be stated that, at present the automobile industry in Iran is in recession, it can only be considered as an active and generating section when, the radical and infrastructural problems of this industry is solved. The industry should become competitive the quality of production should enhanced, the productions should be diversified, and the import tariffs should decreased and so many other issues should be solved in Iran automobile industry. Lack comprehensive plan and strategic in this industry and strategic like other industries in the country will hinder to develop and decrease of problems and the increase in investment security index of the industry.

As new management is in office of ministry of industries and mines and the new decisions for this industry, in future it is expected that the non-revenue generating assets of auto manufacturers will be sold and the non-operational profits will be identified and of this happens the automobile industry will move one step forward to increase of the profit.

Due to high financial expenditures of high interest loans for investments, auto manufacturers are but faced with increase of their financial
expenditure but the out-part manufacturers, such as Enelamin Shock absorber are less involved with this issue.

The suggestion of re-investment is only justifiable when the plans are considered thoroughly and not any re-investment at present condition is justifiable. However, finally it should be stated that the automobile industry, like wise other industries is affected by political issues such as; sanctions but some companies, such as pars khodro co. are enjoying a good condition due to the high profit margin and monopolistic sales. Forecast of production trend of motor – vehicles and commercial vehicles in the globe and Iran’s share in it:

The total production of motor vehicles in the world in 2007 was 69 million (68,932,091). This number has been decreasing during 2008-2010 and decreased to 66.2, 59.3 and 64.8 million and again it may become increasing since 2011.

According to the available data in this sector, the production Iran’s light commercial vehicles will increase during 2007-2012 by 14.2% and will reach to 1,299,906. It is expected that Iran will promote its positions in Top 20 car manufacturing countries and will jump from 16th to 14th in this ranking. In this regard the Iran production and share of production of motor car and light commercial vehicles will be as follows during the above mentioned period.

Table 5.1 Global Share and Global Rank of Automotive Industry in Iran

<table>
<thead>
<tr>
<th>Year</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
<th>2011</th>
<th>2012</th>
</tr>
</thead>
<tbody>
<tr>
<td>Volume of Production (Number)</td>
<td>1,138,626</td>
<td>1,070,176</td>
<td>1,039,209</td>
<td>1,151,244</td>
<td>1,226,723</td>
<td>1,299,906</td>
</tr>
<tr>
<td>Global Share (1%)</td>
<td>1.26</td>
<td>1.22</td>
<td>1.38</td>
<td>1.24</td>
<td>1.27</td>
<td>1.33</td>
</tr>
<tr>
<td>Global Rank</td>
<td>16</td>
<td>15</td>
<td>15</td>
<td>15</td>
<td>15</td>
<td>14</td>
</tr>
</tbody>
</table>

Source: Automotive Industry in Iran, Yearly Magazine (2011)
Table 5.2 Foreign Exchange Revenue and Import of Automobile during 2005-2009

<table>
<thead>
<tr>
<th>Description</th>
<th>2005</th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
</tr>
</thead>
<tbody>
<tr>
<td>Iran Revenue (million Dollars)</td>
<td>64</td>
<td>76</td>
<td>97</td>
<td>70</td>
<td>80</td>
</tr>
<tr>
<td>Import of Automobile (million Dollars)</td>
<td>275</td>
<td>540</td>
<td>878</td>
<td>827</td>
<td>1500</td>
</tr>
</tbody>
</table>

Source: Automotive Industry in Iran, Yearly Magazine (2010)

The decrease in foreign exchange revenue of the government in 1990s had different consequences and outcomes; one of these outcomes was the decreasing trend of automobile import and complete ban on import of automobile. By re-increase of oil price and increase in the foreign exchange revenue of the country in 2000s, demanding new brands and models and seeking variety, in fact broke the ice of automobile import in 2005. The demand of imported automobile market has been intensified during recent years in a way that the import of automobile has increased by fixed import tariff of 90% and even by the 70% increase in imported automobile customs duty since October 2009 ad dismantling 1 old car for import of a car which consumes 6 liters per 700 km., 2 old cars for import of a car which consumes 6-10 liters per 100 and 3 old cars for import of a car which consumes above 70 liters per 700.

The import of automobile increase 9 to 11440, 30897, 42483 and 44200 thousands in 2005, 2006, 2007 and the first 9 months of 2008 which indicates the bull market of imported automobile in Iran.

The import of automobile is directly related to the foreign exchange revenue of the country, as stated earlier the increase of the country’ foreign exchange revenues was the main factor of import of automobile commenced, the foreign exchange revenue of the country was 64 billion dollars in the same year the import was 275 million dollars. By increase in foreign exchange revenue of the country in next year’s the automobile import has been increased proportionately, in a way that in 2006 and 2007 the foreign
exchange revenue of the country was 76 and 97 billion dollars and automobile import was 540 and 878 million dollars. In the first 9 months of 2008 the foreign exchange revenue was 70 billion dollars and the automobile import was 1.5 billion dollars.

5.2.2.12. Comparison of Iran foreign exchange revenue and automobile import during 2005-2008

It is obvious that by increase in the country’s foreign exchange revenue during 2005-2008, the automobile import has increased consequently, but it is expected that the trend of automobile import will be increasing, in case of decrease in foreign exchange revenue.

5.2.2.13. Features of Iran Auto market

• Annual demand of over 1 million automobile.
• Rapid increase in demand due to young population (70%) of the people in Iran are under 30 years old)
• Necessity of dismantling old care (there are about 2 million automobiles which are above 20 years old)
• Low automobile ownership per capital comparing to other countries
• Increase in import of motor car and inevitable decrease in import tariffs.
• Increase in number and diversity of domestic automobile manufacturer.
• Decrease of financial resources and facilities for purchase of automobile by Banks and auto manufacturing companies.
• Decrease of interest on bank loan and decrease of car leasing companies.
• Decrease of government financial assistance in replacing the old cars.
• Severity of the regulations and standards regard in the levels of automobile pollution and safety.
• Change in purchase behavior level of expectation, tastes and wants of customers.
• Change of automobile volé from a capital product to consumer product in families view.

All of these features will add to the complexity of automobile industry.
5.3. Conceptual Framework of Outsourcing

Introduction

The latest framework of outsourcing\(^\text{182}\) was explained as mentioned below. The model comprises of three pronged basis for arriving at the outsourcing performance. It was the identification as done by the propounders of the model who saw the three pronged approach better than anything else. It was the effort of the then researchers that once these three factors would be taken care of them all else would pass out of the relation.

![Figure 5.1: The latest framework of outsourcing (Handley a, W.C. Benton Jr.b 2009)](image)

As seen in the framework, the breakdown of the contents has not been properly identified to be addressed. This would result in the missing of the factors which would also mean that once not listed the same would miss the criterion of evaluation. It is for this end that the researcher in the study at hand has chosen to specify clearly that factors of the framework deemed and identified to be essential for a proper evaluation of the performance in case of outsourcing.

Now, in this chapter these factors which mentioned in the latest model and the other factors which found out in new research for measuring of the model will develop and illustrate.

5.3.1. Strategic evaluation

Strategic evaluation reflects the extent to which the outsourcing team performs a comprehensive evaluation of the strategic implications of outsourcing a business activity. The degree to which firms effectively perform a strategic evaluation is concurrently reflected by their evaluation from a risk and capability perspective. The capability or resource evaluation is grounded in the resource based view of the firm, while the strategic risk assessment is guided by transaction cost theory. The resource based perspective stipulates that while demarcating firm boundaries an organization must consider the degree to which the firm’s resources and capabilities contribute to the development of a sustainable competitive advantage. Firms must develop a thorough understanding of their core competencies and how a particular business activity is related to the successful achievement of broader strategic objectives while deciding whether or not to outsource a particular business activity. Thus, a thorough evaluation of the current and potential strategic value of the capabilities of a firm is a critical aspect of the overall strategic evaluation. The transaction cost perspective suggests that organizations must consider the costs and resources required to effectively coordinate with an external party and mitigate the risks inherent in external sourcing. Common risks often associated with the use of an independent external organization
include provider shirking due to imperfect observability. Transaction cost theory would suggest that the level and implication of these risks must be considered while developing the strategic business case for outsourcing. Conceptually, the firm’s desire to develop a comprehensive understanding of outsourcing’s strategic implications initiates an evaluation along these two dimensions.

Thus, strategic evaluation is modeled as a multi-dimensional reflective construct. This conceptualization is supported by studies conducted previously which identify the complementary nature of the resource based view of the firm and transaction cost theory for describing firm boundary decisions made in practice.

5.3.1.1. Capability evaluation

Capability evaluation is the extent to which the outsourcing team evaluates the strategic value of the capabilities and resources associated with the business activity, considering the organization’s current and anticipated sources of competitive advantage. It is broadly suggested that an organization’s capabilities at performing a function or activity must be evaluated while making outsourcing decisions. This capability evaluation must consider not only how well an organization performs but also the strategic importance of the activity or function. The strategic value derived from being a high performer in a certain area must be considered. This notion is the essence of the Resource Based View (RBV) of the firm, and also reflects what Prahalad and Hamel (1990) have coined the organization’s core competencies. Quinn and Hilmer (1994) further suggest that organizations must focus on developing a few core competencies internally and consider outsourcing the rest. This strategic focus can potentially free resources to be concentrated in areas that are expected to yield competitive advantage. The capability evaluation must also consider what skills or capabilities may be critical to competitive differentiation in the future as markets evolve, present non-core capabilities may become core in the future (Helper et al., 2000).
5.3.1.2. Strategic risk assessment

Strategic risk assessment represents the degree to which the outsourcing team evaluated the multitude of strategic risks associated with outsourcing the business activity. With outsourcing there is a variety of strategic risks which needs to be assessed. First, organizations are making information, once considered proprietary, available to an external organization. Thus, firms must consider the ramifications to intellectual property while choosing to switch to an external sourcing structure. Walker (1988) terms this concern as “diffusion risk” while Aron et al. (2005) refer to it as “poaching”. A second strategic risk is supplier shirking or moral hazard, which arises to due goal misalignment and an imperfect ability to observe all of the provider’s actions. Finally, transaction cost theory asserts that in the presence of uncertainty, transaction specific assets, and contractual incompleteness firms must heavily evaluate the risk of providers acting opportunistically. This has become known as the classic “hold-up” problem. This portfolio of concerns must be explicitly assessed as part of a comprehensive strategic evaluation.

5.3.2. Contractual completeness

Contractual completeness is the extent to which the outsourcing firm and chosen provider develop a contract which effectively coordinates resources and addresses identified inter-organizational risks. Poppo and Zenger (2002) assert that a more complex contract specifies “promises, obligations, and process for dispute resolution.” Effective contracting practices such as clear service level agreements and performance contracting with well established penalty and reward structures are suggested to offer benefits in terms of improved goal alignment and reduced strategic risks. More specifically, it has been suggested that a more complete contract serves two fundamental functions: coordination and control (Mellewigt et al., 2007). The establishment of coordinating provisions outlines how each party’s resources will interface across firm boundaries (Mellewigt et al., 2007). Coordination provisions clarify mutual expectations as well as delineate roles,
rules, programs, and procedures that enable the joint endeavour to accomplish collective goals (Mellewigt et al., 2007). On the other hand, control provisions are designed to determine and influence what the parties would do (Das and Teng, 1998). The intent of contractual control provisions is to make outcomes more predictable (Das and Teng, 1998; Poppo and Zenger, 2002) and mitigate the relational risk associated with an inter-organizational arrangement (Das and Teng, 1998; Mellewigt et al., 2007). Finally, Argyres and Mayer (2007) studied contract design from a firm’s capability perspective. Their study highlights the need to have a cross-functional team involved in the development of the contract due to various groups within the firm having uniquely qualified capabilities to develop certain contractual provisions.

5.3.2.1. Offer

It is an expression of willingness to a contract on specific set of terms, made by the offeror with the intention that, if the offer is accepted, he or she will be bound by a contract. Treitel defines an offer as "an expression of willingness to contract on certain terms, made with the intention that it shall become binding as soon as it is accepted by the person to whom it is addressed" namely the "offeree". An offer is a statement of the terms on which the offeror is willing to be bound specifically with the offeree. It is the present contractual intent to be bound by a contract with definite and certain terms communicated to the offeree. The "expression" referred to in the definition may take different forms, such as a letter, newspaper, fax, email and even conduct, as long as it communicates the basis on which the offeror is prepared to contract.

Whether two parties have an agreement or a valid offer is an issue which is determined by the court using the objective test. Therefore the "intention" referred to in the definition is objectively judged by the courts. In the English case of Smith V Hughes the court emphasized that the important thing is not a party's real intentions but how a reasonable person would view the situation. This is due mainly to common sense as each party would not wish to breach his side of the contract if it would make him or her culpable to

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damages, it would especially be contrary to the principle of certainty and clarity in commercial contract and the topic of mistake and how it affects the contract. As a minimum requirement the conditions for an offer should include at least the following four conditions namely delivery date, price, terms of payment that includes the date of payment and detailed description of the item on offer including a fair description of the condition or type of service. Without one of the minimum requirements of condition an offer of sale is not seen as a legal offer but rather seen as an advertisement.

5.3.2.2. Acceptance

It can be termed as an expression of absolute and unconditional agreement to all the terms set out in the offer. It can be oral or in writing. The acceptance must exactly mirror the original offer made.

For an Acceptance, an essential requirement is that the parties had each from a subjective perspective engaged in conduct manifesting their assent. Under this meeting of the minds theory of contract, a party could resist a claim of breach by proving the absence of intent to be bound by the agreement, only if it appeared subjectively that he had so intended. This is unsatisfactory, as one party has no way to know another's undisclosed intentions. One party can only act upon what the other party reveals objectively to be his intent. Hence, an actual meeting of the minds is not required. Indeed, it has been argued that the "meeting of the minds" idea is entirely a modern error: 19th century judges spoke of "consensus ad idem" which modern teachers have wrongly translated as "meeting of minds" which actually means "agreement to the [same] thing".

The requirement of an objective perspective is important in cases where a party claims that an offer was not accepted and seeks to take advantage of the performance of the other party. Here, we can apply the test of whether a reasonable bystander (a "fly on the wall") would have perceived that the party has impliedly accepted the offer by conduct.
5.3.2.3. Lawful Consideration

Consideration is the concept of legal value in connection with contracts. It is anything of value promised to another when making a contract. It can take the form of money, physical objects, services, promised actions, abstinence from a future action, and much more. Under the notion of "pre-existing duties," if either the promisor or the promisee already had a legal obligation to render such payment, it cannot be seen as a consideration in the legal sense.

In common law it is a pre-requisite that both parties offer some consideration before a contract can be thought of as binding. However, even if a court decides there is no contract, there might be a possible recovery under Quantum meruit (sometimes referred to as a Quasi-contract) or promissory estoppel.

5.3.2.4. Certainty of Meaning & Possibility of Performance

By Certainty of meaning we mean to put forth that the wording of the agreement need to be clear and not uncertain or vague. For example if ‘A’ agrees to sell 5 tons of oil to ‘B’. Here, the kind of oil is not clearly mentioned. Therefore, on the ground of uncertainty, this agreement stands void. If the meaning of the agreement can be made certain by the circumstances, it could be treated as a valid contract. For example, if John and Mathew are sole traders of coconut oil, the meaning of the agreement can be made certain by the circumstance and in that case, the agreement can be treated as a valid contract.

Possibility of performance, if the act is impossible of performance, physically or legally, the agreement cannot be enforced by law. There must be possibility of performance of the agreement. Impossible agreements like one claim to run at a speed of 1000km/hour or Jump to a height of 100feet etc. would not create a valid agreement. All such acts which are impossible of performance would not create a valid contract and cannot be treated as a
valid contract. In essence, there must be possibility of performance must be there to create a valid contract.

5.3.2.5. Environmental Factors

Environmental factors are also considered alongside financial factors in decision making. It involves looking beyond the traditional parameters and making decisions based on the whole life cost, the associated risks, measures of success and implications for the prevalent environment. Making decisions in this way requires strategically setting environmental factors into a broader procurement context that includes value for money, and corporate and community priorities:

- Value for money considerations such as, price, quality, availability, functionality;
- The entire life cycle of products;
- Environmental aspect – the effects on the environment that the goods, services and civil works have over the whole lifecycle (green procurement); and
- Social aspects, such as sustainable supply chains and the effects of issues such as labour conditions, including child labour provision, occupational health and safety and compliance with relevant industrial and environmental regulations.

5.3.3 Relationship management

Relationship management represents the degree to which the outsourcing firm has strived to establish and maintain a mutually beneficial relationship with the supplier or vendor. The supply chain literature has provided empirical support for relationship management being modeled as a multidimensional reflective construct.

Effective cooperation often entails investment in relationship specific processes, procedures, and technologies (Dyer and Singh, 1998). Firms are often reticent about investing in relationship specific resources unless the exchange is characterized by high levels of trust and mutual commitment. On the other hand, making relationship specific investments expresses trust and
goodwill which gains commitment from the other party. Morgan and Hunt\textsuperscript{186} (1994) find strong evidence that commitment is critical for effective cooperation in exchange relationships. Thus, it is clear that commitment and cooperation are intertwined in establishing mutually beneficial exchange relationships. That is to say that commitment and cooperation act in a complementary manner. It is the nexus of commitment and cooperation that is of interest in this study.

5.3.3.1. Relationship commitment

Relationship commitment is the degree to which the outsourcing firm feels pledged or obligated to the development and maintenance of a stable relationship with the supplier or vendor (Prahinski and Benton, 2004). Anderson and Weitz (1992) describe relationship commitment as “a willingness to make short-term sacrifices to maintain the relationship.” For outsourcing relationships to work, it requires a strong commitment from both parties (Anderson and Weitz, 1992). Although longer-term relationships can bear significant benefits, the road will not always be smooth. Even cooperative relationships are often characterized by significant levels of uncertainty. Thus, it is important that the parties sufficiently value the relationship and are willing to expend resources and work to maintain it (Morgan and Hunt, 1994). Without commitment from both leadership teams, it would be easy to regress into traditional adversarial thinking. For this reason, the outsourcing literature has cited the need to have involvement from top management as well as mid-level management in the relationship management process. Ultimately, the organization must view the engagement as a partnership (Prahinski and Benton, 2004) where the driving question is “how do we maximize the total system value” rather than “how can we maximize our portion of the pie at the expense of our provider”. If this mentality is not maintained, goal alignment will erode and opportunism will likely follow.

5.3.3.2. Cooperation

Cooperation represents the extent to which the outsourcing firm works with the provider to maintain flexibility, plan collaboratively, and jointly work through problems as they arise (Prahinski and Benton, 2004). One hallmark of cooperation is extensive information sharing. Frequent sharing of important, sometimes proprietary, information allows the exchange partners to complete tasks more effectively (Mohr and Spekman, 1994). As the relationship becomes more strategic, the type of information shared with the supplier becomes more critical often including long-term forecasts, planning information, and future product designs. Closely related to rich information exchange is the idea that true buyer–provider partnerships work collaboratively in many areas. Collaboration entails joint efforts by the two organizations. Common collaborative initiatives include joint problem resolution or continuous improvement mutual strategic planning (Dwyer et al., 1987; Helper et al., 2000), and joint product or service development efforts (Shin et al., 2000; Yeung, 2008). Finally, as noted in Dwyer et al. (1987), “divergence of goals and role preferences” is inevitable as conditions change and the relationship evolves. Therefore it is critically important to approach such conflicts and disputes constructively, with a mindset of improvement. As stated by Anderson and Narus (1990), “When partner firms use disagreements as a means of ‘clearing the air’ of potentially harmful tensions and ill-will, conflict can have functional and productive consequences.” Hence, strong inter-organizational relationships are characterized by a significant cooperative orientation in which both firms can benefit from the collective efforts.

5.3.3.3. Enhancing Innovation Capability

Innovation is the beginning of creation of something new which is possibly better that that which is presently available. Innovations are normally done based upon need and requirement. That means to say that every innovation, maybe on the same product or service, could be innovated and made use of differently by others. It is only apt that this capability is continuously improved or in other words the same is enhanced from that which is done before. Doing something new is that which is accepted.
Bringing out the same over and over again is at times not acceptable and taken to be stereotyped. In the context of the study at hand it could be said that an outsourcee could have the similar activity from various outsourcers. The methodology may need to differ based on the needs and requirements of the outsourcer.

It is the need of the hour for an outsourcee to be viable that they need to come out with possible solutions which would be of utility for the outsourcer and also look something new to that being done and followed by others. Innovation in other words could also be called as change and it is something which is continuous.

**5.3.4. Outsourcing Performance**

Performance is measured in terms of the cost and outcome. The cost is calculated based the price value of the activity, namely the amount incurred for the activity to be performed and is compared with the performance. It is to be evaluated as to if the performance received is that worth based on the cost paid for the same. The sections to follow would bring forth a brief idea on the same.

**5.3.4.1. Annual Costs**

Annual costs can be termed as what something might cost per year. Take for example, if you pay an amount, say 50 per month for a particular expense, then the annual cost (per year) would be 600. In short, annual costs can be said to be the cost incurred for a particular (or collective) activity for a period of one year. It could be the cost incurred to maintain a family (which includes all its expenses) for a year which can be termed as the annual cost to maintain the family.

**5.3.4.2. Flexibility**

Flexibility can be termed as the ability of a system, such as a manufacturing process, to cost effectively varies its output within a certain range and given timeframe. It means that no fixed variable is in place and can be altered as per the requirement from time to time. The element of rigidity is not present.
Flexibility can also be used as an attribute of various types of systems. In the field of engineering systems design, it refers to designs that can adapt when external changes occur. Flexibility has been defined differently in many fields of engineering, architecture, biology, economics, etc. In the context of engineering design one can define flexibility as the ability of a system to respond to potential internal or external changes affecting its value delivery, in a timely and cost-effective manner. Thus, flexibility for an engineering system is the ease with which the system can respond to uncertainty in a manner to sustain or increase its value delivery. Uncertainty is a key element in the definition of flexibility. Uncertainty can create both risks and opportunities in a system, and it is with the existence of uncertainty that flexibility becomes valuable.

5.3.4.3 Reliability

Reliability refers to the consistency of a measure. A test is considered reliable if we get the same result repeatedly. For example, if a test is designed to measure a trait (such as introversion), then each time the test is administered to a subject, the results should be approximately the same. Unfortunately, it is impossible to calculate reliability exactly, but it can be estimated in a number of different ways. There are various types of reliability like

5.3.4.4 Quality Performance

Quality performance refers to testing or observational procedures that are designed to identify small increments of difference in the quality (not just quantity or presence/absence) of actions, behavior, performances, or products created by the target individual being assessed. Quality performance measures help in the identification of borderline or mild delays.

5.3.4.5. Human Implementation

This is where the human factor comes into picture. No matter what needs to be done, there is always a human element present in the execution which does, at times, affect the performance to a very great extent. It is to be kept in mind that the human element is one among the four factors of production (or any activity) namely land, labour, capital and organization. The
performance of the human element does play a role in any activity from the quality to the quantity.

5.3.5. Organizational performance Alignment\textsuperscript{187}

The purpose of Organizational Performance Alignment is to enhance the alignment of performance results across individuals, workgroups, and units with organizational performance and business objectives. Organizational Performance Alignment builds on the analyses of competency-based processes initiated in the Quantitative Performance Management and Organizational Capability Management process areas. Where those analyses focused narrowly on process performance, analyses of performance alignment expand this focus to evaluate how the various components of performance fit together across workgroups, units, and the entire organization. Practices within this process area knit together a complete picture of performance within the organization and how the integration of its various business activities are affected by workforce practices and activities. These analyses allow management to align performance across the entire enterprise and to use workforce activities strategically to achieve organizational business objectives.

5.3.5.1. Competency Integration

The purpose of Competency Integration is to improve the efficiency and agility of interdependent work by integrating the process abilities of different workforce competencies. Competency Integration interweaves different competency-based processes to achieve a seamless process based interaction among individuals from different competency communities. These integrated competency-based processes provide more tightly interlaced interactions to allow problems among product, service, or work dependencies to be identified and corrected much earlier. Competency Integration involves analyzing work to identify opportunities to integrate the processes used by different workforce competencies. These integrated competency-based processes are defined and work situations are tailored for their use.

\textsuperscript{187} Bill Curtis (TeraQuest Metrics, Inc.), William E. Hefley (Q-Labs), Sally A. Miller, 2001, "People Capability Maturity Model\textregistered (P\textsuperscript{CMM\textregistered}) Version 2.0", CMU/SEI-2001-MM-01, Software Engineering Institute, Copyright 2001 by Carnegie Mellon University
Workforce practices and activities such as staffing, performance management, compensation, and the work environment are adjusted to support multi-disciplinary work using integrated competency-based processes.

5.3.5.2. Empowered Workgroup

The purpose of Empowered Workgroups is to invest workgroups with the responsibility and authority for determining how to conduct their business activities most effectively. Empowerment involves delegating responsibility and authority for work results to a workgroup and training its members in the skills and processes required for working in an empowered environment. Empowered workgroups are managed as an entity, rather than as individuals. The work environment is adjusted to support empowered performance by workgroups. Empowered workgroup members accept increasing responsibility for the performance of workforce practices such as recruiting, selection, performance management, reward, training, development, and compensation activities that are appropriate to the structure and function of the empowered workgroup. Workgroup performance and contributions to it are considered in making individual compensation decisions, as well as in recognizing and rewarding outstanding performance.

5.3.5.3. Organizational Capability Management

The purpose of Organizational Capability Management is to quantify and manage the capability of the workforce and of the critical competency-based processes they perform. The organization’s capability in a specific workforce competency is assessed from the number of individuals in a competency community and the aggregated level of knowledge, skill, and process ability that they possess. Data regarding competency development trends are defined and collected, and trends are compared to objectives in the strategic workforce plan. The organization evaluates the impact of its workforce practices on capability in each of its workforce competencies. Organizational Capability Management also involves characterizing the process capability of critical competency-based processes through process performance baselines and quantitative performance models. These
capability results are used in planning and managing the performance of competency-based processes. The impact of workforce practices on the capability and performance of competency-based processes is quantified and managed and the results of these analyses are used in organizational decisions. The results of these analyses are used in adjusting workforce practices to improve their impact on performance and results.

5.3.5.4. Quantitative Performance Management

The purpose of Quantitative Performance Management is to predict and manage the capability of competency-based processes for achieving measurable performance objectives. Individuals and workgroups determine which competency-based processes contribute most to achieving unit objectives and set measurable objectives for the performance of these processes. Committed work is estimated and planned using process performance baselines developed from past performance of the relevant competency-based processes. A quantitative performance management strategy is developed for identifying, measuring, and analyzing the performance of the competency-based processes that most contribute to achieving unit objectives. Performance data are collected and analyzed according to the strategy. The performance of competency-based processes is brought under quantitative control. Corrective actions are taken when the performance of competency-based processes deviates significantly from performance objectives.
The model as depicted in figure 5.3 has evolved from that as appearing in figure 5.1 above. The study at hand commenced with the model in figure 5.1, as given by Sean M Handley and W C Benton, wherein outsourcing performance was dependent on the strategic evaluation, contractual completeness and relationship management. As seen in the initial model of commencement of the study, the factor of strategic evaluation contained in itself a comprehensive evaluation performed by the outsourcing team on the strategic implications of outsourcing the business activity. Contractual completeness contained the extent to which the outsourcing firm and chosen provider develop a contract which effectively coordinates resources and addresses identified inter organizational risks. In the aspect of relationship management the degree to which the outsourcing firm has strived to establish and maintained a mutually beneficial relationship with the chosen supplier or...
vendor has been looked into. All the above put together gave out the outsourcing performance which was the initiative relative to expectations along the dimensions of cost, quality, responsiveness and reliability.

The factors deemed essential to the framework of outsourcing then were represented as Strategic evaluation being contained with capability evaluation and strategic risk assessment. Strategic evaluation leads to contractual completeness, outsourcing performance and relationship management where relationship commitment and cooperation were a part.

In the study at hand, the essential framework took a complete revamp and the resultant model which emerged portrays that (as represented in the figure 5.3) though as seen in the previous work capability evaluation and risk assessment form strategy evaluation. The variation and importance of the conceptual binding rests in the framework, as specified by the researcher in the study at hand, to evolve with the model as work upon. The researcher has taken into consideration the environmental factors along with the offer, acceptance, lawful consideration and certainty and possibility performance which need to be imbibed in the contractual completeness in order to make much more and better impact keeping in mind the present modern day scenario. The performance of outsourcing has further been broken down to annual costs, flexibility, reliability, quality performance and human implementation which need to be taken care-off and looked into so as to bring about its true essence. Finally competency integration, empowered work group, organizational capability management and quantitative performance management have all been bundled up to be the framework which would bring out the organizational performance alignment.

As mentioned, the model as generated as a resultant of the study at hand has been done so by the researcher based on the facts and the other related parameters as relevant in the present day scenario. The main requirement being that the framework has been further broken down and the contents have been made specific which could enable the identification of that area which needs the maximum amount of attention. This being the case and
done it would bring about a clear understanding of the factors and also the cause and effect relationship which would allow for quick remedial action to be taken up in order to bring back the rhythm of the entire process of outsourcing.