KPMG

KPMG'S AUTO EXECUTIVE SURVEY 2004

CLIENT PREVIEW

INTRODUCTION

Across the industry, executives this year are significantly more optimistic that future profitability will improve. However, substantial worry remains that American-based vehicle manufacturers (VMs) are facing a relentless erosion of market share by a swelling tide of attractive, less expensive Japanese and Korean cars and trucks.

In a mixed bag of positives and negatives, executives feel that:

- Manufacturing quality has improved while costs have declined, thanks to advanced technology, yet quality remains the number one industry issue.
- Concerns about new regulations and the environment are rising.
- Transplants in the United States are increasingly appealing sources of business for U.S.-based suppliers.
- The need to control costs is becoming a way of business life; outsourcing—or the threat to outsource—is seen as an effective strategy.
- Further consolidation is expected throughout the industry—for VMs, suppliers, and dealers.
- U.S. model mix will continue to shift away from cars, with crossovers, SUVs and pickups to grow faster and the minivan possibly staging a rebound.
- Globally, the car will prevail but all other vehicle types will also find buyers.
- Luxury vehicles will continue to grow in share as long as current circumstances hold.
- Safety innovations are expected to continue to lead technological advances and garner the biggest investments from car companies.
- Fuel efficiency will jump in consumer purchase criteria.
- Growth of sales incentives will level off.
- Consumer loyalty will continue to decline across the board.

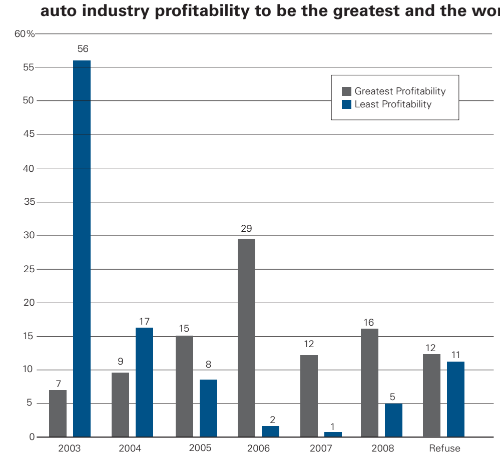
The 2004 survey, conducted in October and November 2003, is the third annual KPMG tracking study of automotive executive opinions. It consisted of 100 qualitative and 10 quantitative interviews of U.S.- and non U.S.-based executives. Variations among groups of respondents are discussed when they are statistically significant from past years.

THE ECONOMY IS IN RECOVERY MODE

With the overall economy recovering, job losses stabilizing and in some sectors starting to reverse, and consumer spending strong, automotive executives believe that profits will return to the industry starting in 2005, with nearly one in three (29 percent) picking 2006 to be the most profitable of the next five years. Further, they believe that 2003 will turn out to be the worst for business in the half decade from 2000 to 2005. However, another 28 percent of executives think the most profitable year will not occur until 2007 or 2008. All told, 57 percent of executives surveyed believe that the effects of the economic turnaround will be delayed for the car industry until 2006 or beyond.

These results follow a pattern—survey respondents tend to find greater profits in the future than in the past or present, and the future interval for significant improvement tends to be two or more years. However—another sign that optimism is rising—in 2002 executives were divided on which would be the most profitable year from 2000 to 2005, with 29 percent voting for 2000 and 30 percent voting for 2005. Note that the forward interval was *three* years. This year only 17 percent thought 2000 would turn out to be the most profitable year from 2000 to 2005, while 37 percent voted for 2005, a two-year interval. Confidence among executives is gaining strength. (The year 2000 holds the current record for Big Three highs in revenues or profits or both.) [Source: 2000 to 2002 annual reports]

For which of the following years do you expect overall auto industry profitability to be the greatest and the worst?

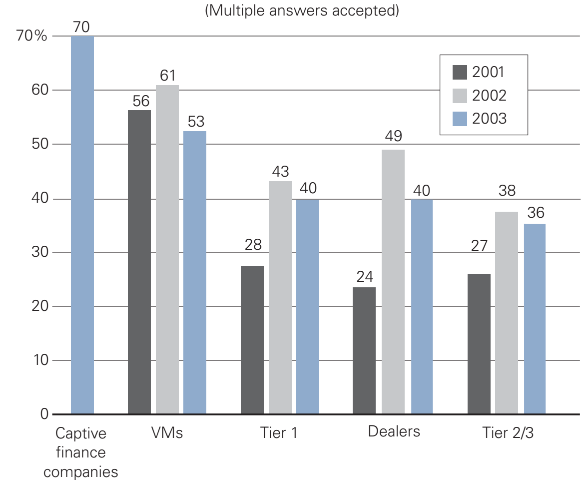


Source: KPMG LLP

Nevertheless, executives feel that significant profit increases will continue to be elusive. Noted one North American OEM executive, "Automaker profitability cannot get any better than it is now. It'll remain flat." And profits are not likely to come from vehicle manufacturers. A large majority of executives surveyed—70 percent—think captive finance arms will be more profitable than other industry segments over the next five years. Meanwhile, executives do not agree on which industry segments will benefit most from the recovery—VMs, Tier 1 suppliers, Tier 2/3 suppliers, or dealers—with all four segments trending toward parity: VMs declined from 61 to 53 percent, dealers slipped from 49 to 40 percent to tie Tier 1 suppliers, and Tier 2/3 suppliers remained about the same at 36 percent.

Interestingly, global overcapacity (a new query this year) does not appear to many executives to be a mammoth obstacle. Nearly two thirds of those queried (62 percent) think overcapacity is less than 21 percent and about half (48 percent) said it is between 11 and 20 percent. Noted one North American Tier 1 executive, "Overcapacity is a medium-sized problem." However, not all regions are the same. A European Tier 2 executive noted, "Overcapacity is the biggest problem in the Far East and America."

Which types of companies do you expect to be the most profitable over the next five years?
(Multiple answers accepted)



Source: KPMG LLP

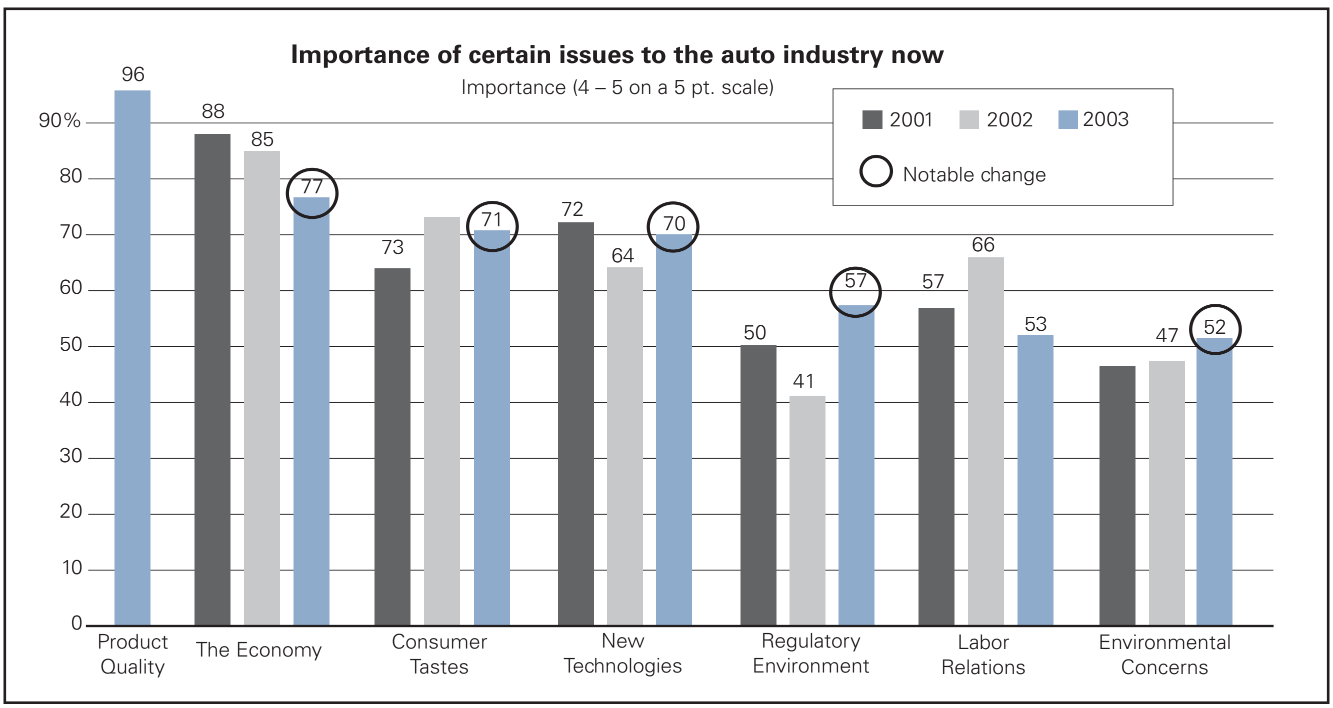
QUALITY THE BIGGEST ISSUE

While worries about the impact of the economy on business remain high, they are abating somewhat. As might be expected, other concerns are coming to the fore. Among eight key industry issues (two of them new for this year's survey), the leading immediate issue of the past two years, the **economy**, fell from 85 to 77 percent in importance. **Labor relations** also declined, dropping from third to sixth in rank and from 66 to 53 percent in importance, presumably as a result of the labor agreements concluded between the auto unions and Detroit last fall.

Instead this year, **product quality**, a new category, usurped the economy as the number one issue, garnering near unanimity in importance (96 percent). A related issue, also new for 2003—**new products**—tied the economy at 77 percent. Implied in these results and echoed throughout this year's interviews are the effects being felt by the intensity of competition throughout the industry. Noted one Tier 1 executive from outside North America, "Our best strategy for future growth will be high quality."

Consumer tastes and **new technologies** remain third and fourth in relative importance to the industry, according to respondents.

In addition, 57 percent of executives feel the **regulatory environment** is an important issue, ranking it fifth—its highest level in the three-year history of the survey. **Environmental concerns** also rose, albeit more modestly. Taken together, these two results signal an expected change toward more involvement by regulators and legislators in the industry's future. "Regulations are going to be tougher at the federal level," predicted one North American Tier 1 executive. "It's necessary."



Source: KPMG LLP

THE GLOBAL AUTO INDUSTRY

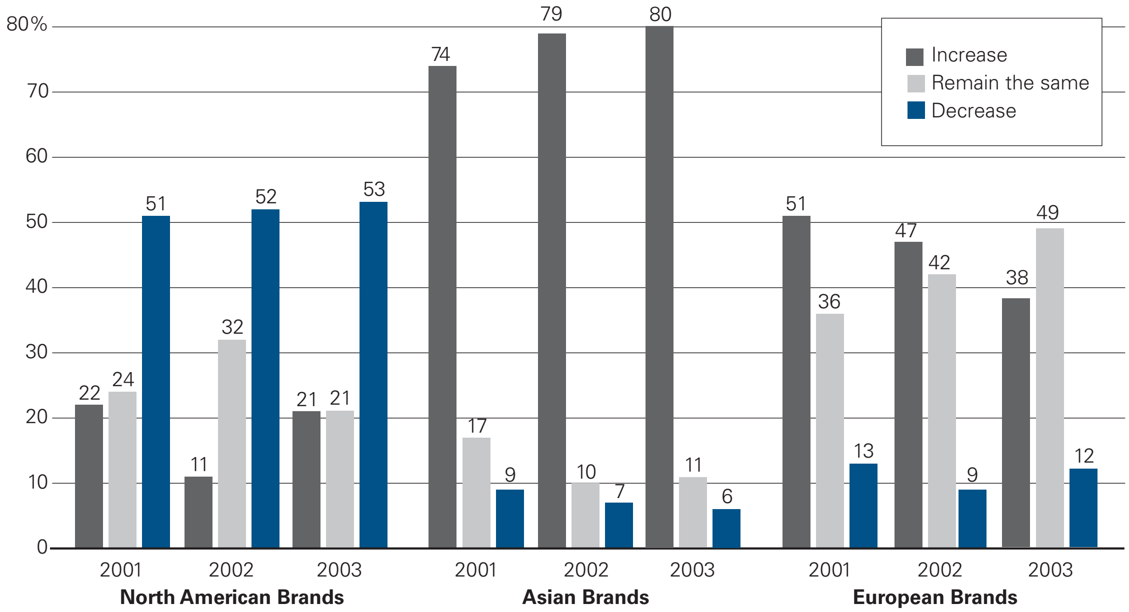
How will the world's global automobile market change in the next five years? With cross-border activity more fluid—four of five responding executives feel strongly it will increase in the near term—automakers and suppliers are increasingly free to operate internationally. Expectations for the global market-share growth of Asian brands remain exceedingly high—a three-year trend that has slightly strengthened, from 74 to 80 percent. Supporting this expectation, two thirds of respondents (67 percent) strongly agree that over the next five years "restructured Japanese automakers will continue to leverage greater efficiency into greater market share." Last year 70 percent agreed.

European brands are expected to grow at a slower rate or perhaps just hold their own. Over three years, the number of executives who feel European brands will gain global market share has fallen from 51 percent in 2001 to 38 percent this year, while those who think the European share will hold steady rose from 36 to 49 percent.

Half of respondents (53 percent) think North American brands will lose global market share over the next five years, a proportion identical for three consecutive years. One slight change: last year 32 percent felt North American brands would maintain then-current market share for five years, up from 24 percent in 2001, but this year the proportion fell 11 points to 21 percent. Providing the supplier perspective, one North American Tier 1 executive noted, "Our volume with Detroit is holding steady, but as a percentage of our overall business, it's

Do you expect these area brands to increase, decrease, or remain the same in terms of global market share over the next five years?

Responses may not total 100% since those indicating they do not know are not included.



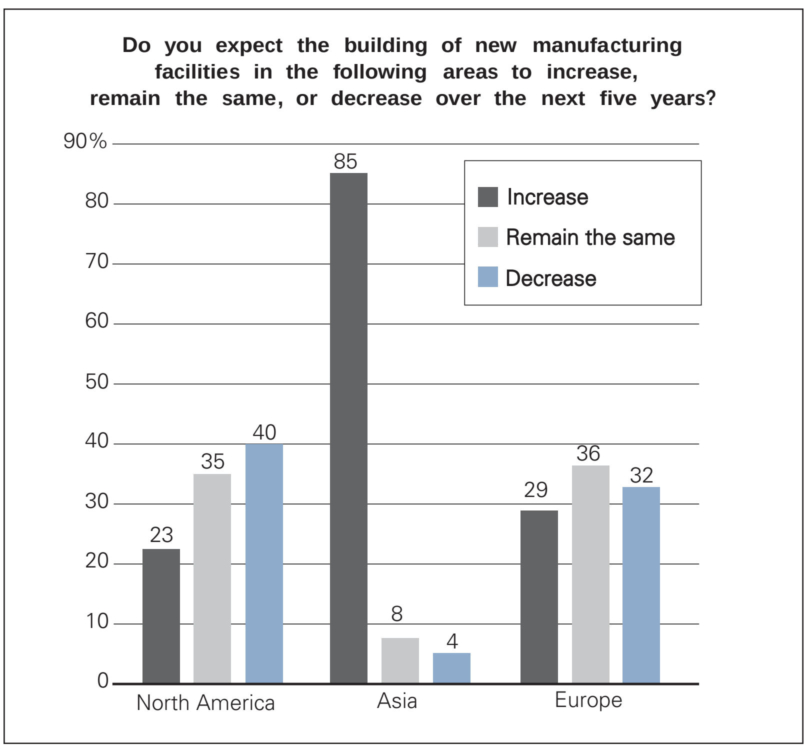
Source: KPMG LLP

declining." This scenario offers room for improvement, but it may not be forthcoming. Only half (50 percent) feel that U.S. makers will become "more efficient and more competitive" over the next five years, down slightly from 56 percent in 2002. Interestingly, North American executives were much more likely to expect a continuing decline in global market share for North American brands (68 percent) than non–North American executives (40 percent).

The North American market will be a key automotive battleground, and for the time being outsiders appear to have an edge. "It's not a level playing field," said one North American Tier 1 executive. "The domestic VMs are very old companies, with older workforces, pension costs, and healthcare liabilities." Said another, "The Asian transplants are very definitely going to continue to gain market share in the U.S." For the first 11 months of 2003, U.S. market share for the Big Three was 60.0 percent, down from 61.5 percent for the same period last year. U.S. market share for Asian brands was 32.8 percent, up from 31.6 percent last year. The European share was 7.2 percent, about the same as last year (6.9 percent).

Where North American brands have a better chance to grow is Asia, especially China. Nine in ten respondents (90 percent) feel strongly that consumers in Asia will become "a major source of growth" for global automobile demand over the next five years, an increase of 24 points in one year. Two reasons are the burgeoning Chinese middle class and ready financing. A large majority of respondents (85 percent) feel Asia will experience growth in new manufacturing facilities over the next five years compared to 23 percent for North America and 29 percent for Europe—indeed, 40 percent thought there will be a *decrease* in North American manufacturing facilities.

Asia is likely to be a turning point for the industry. Initiating what amounts to a new phase offers auto companies and their suppliers an opportunity for a fresh start, providing them the chance to rectify past mistakes, give existing brands new vitality, and create leaner organizations based on information technology and innovative workflow. Whether or not the corporate cultures involved are able to seize this opportunity remains to be seen.



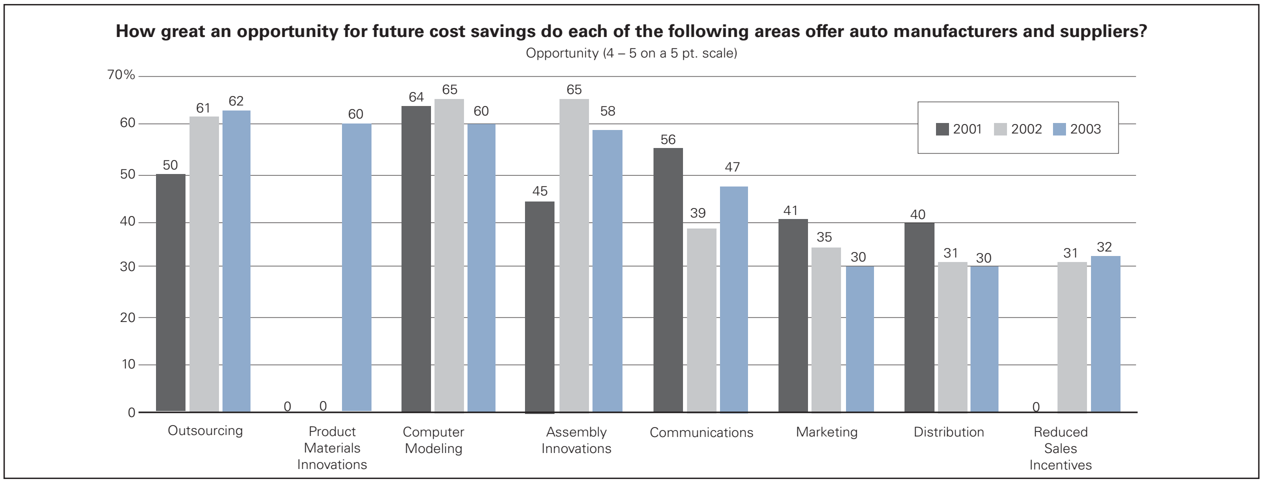
Source: KPMG LLP

COST FOCUS TO CONTINUE

With global market share shifting to Asian brands, profits scarce, and customer loyalty in continued decline, the cost-cutting programs in place at most companies in the industry must be ingrained.

The probable sources of future cost savings have changed in the minds of executives over the last three years. The overall trend in respondents' sentiments since 2001 is an easing away from internal sources of cost savings toward external sources such as lower-cost providers—not for strategic reasons, but because further dramatic cost savings from internal operations may be more difficult than in past years. Noted one non–North American Tier 1 executive, "Cost-savings are achieved by going abroad. [The automakers] are as automated as they can be these days." Echoed a North American VM executive, "The labor rates are a very large part of the cost of a car, even with all the automation. We've done all we can." And more automation may not be forthcoming. Said a North American Tier 1 executive, "There's not a lot of spare cash around to go for new technology." And while respondents see product development cycles shrinking, they speak of this trend in terms of moving closer to the consumer's needs, not reducing costs. To review the cost-saving opportunities identified in eight categories (sales incentives was added last year, product materials innovation in 2003):

- **Computer modeling** has been either first or second all three years.
- **Outsourcing**, which rose ten points from third in 2001 to second last year, now leads all categories with 62 percent of respondents affirming they think it is a major means of cost savings in the future.
- **Assembly innovations/plant flexibility**, which was fourth in 2001, then rose to a tie for first last year at 65 percent, slipped back slightly to 58 percent this year and is now third.
- **Product materials innovation**, new for 2003, was identified by 60 percent of respondents as a major source of potential savings, enough for second place.
- **Communications** (internal e-commerce via extranet/intranet), second in 2001 with 56 percent, dropped precipitously last year to 39 percent, but rebounded somewhat in 2003 to 47 percent, probably due to growing e-commerce between VMs and dealers.
- **Incentives**, new last year, stayed the same this year with less than a third of respondents confident in obtaining significant future cost savings here.
- **Distribution** and **marketing**, tied this year for last place, were little changed from 2002 (distribution lost five points, not a significant drop), but both are now down 10 or more points since 2001.



Source: KPMG LLP

OUTSOURCING, SUBCONTRACTING, AND RELATIONSHIP DYNAMICS

The trend for OEMs to shift certain tasks and processes to big suppliers appears to be accelerating, pushed by the further need to reduce costs. Indeed, one North American Tier 1 executive thought that, eventually, "OEMs will only deal with super suppliers and Tier 1s." This pass-along of responsibilities for lower costs inevitably results in a cascade effect. "Manufacturers are not only subcontracting the parts but also the design, performance, and everything else," complained a non–North American Tier 1 executive. "The burden falls on all the suppliers, and then we have to squeeze our Tier 2 and Tier 3 suppliers."

One aspect of this shift may be the start of a fundamental transformation. "There is a definite move of OEMs to marketing and [away from] manufacturing tasks," said a North American Tier 2 executive. But the executive pointed to a significant downside: "They are stripping themselves of their engineering and manufacturing technology and expecting their supplier to do it for free." One North American Tier 1 executive offered a scenario with a sharp division of labor: "The VMs should focus on what they really do well (e.g., branding, sales, distribution)." But the executive noted a significant obstacle: "The problem is that they see their core competency as manufacturing." This helps explain why only a third (34 percent) of this year's executives thought VMs will evolve into strategic marketing organizations, the same as last year but down from 42 percent in 2001.

If managing the supply chain is key to future VM profits, some companies will be better at it than others. In North America, many executives believe, the transplants are better at working with suppliers. One North American Tier 2 executive said, "Their willingness to listen and their engineering expertise give them a better product." A Tier 1 executive said by way of comparison that a particular transplant "is a much less bureaucratic company. They tell you want they want, you negotiate, and that's the way it is. One of the domestics has a pre-production approval package that is 454 pages long. For the transplant, it's 9."

North American VMs, said executives, have more adversarial, one-way relationships with suppliers. "The big manufacturers are outsourcing like mad. They are switching to people like us," noted one non–North American Tier 2 executive. "But the cost drive-downs are enormous." A North American Tier 1 executive summed up the feelings of many suppliers: "Right now, OEMs are not doing anything to cut costs internally. The European and Asian VMs are a little more reasonable, but the Big Three essentially say, 'meet our price or we'll find another supplier.' There is no longer any collaboration between [U.S.] VMs and suppliers." Another noted that "they're using China as a lever. I cringe every time they tell me what I've got to make a [part] for." A Tier 2 executive spelled out a major frustration with the OEM/supplier dynamic in the United States and offered a possible explanation: "They want cost-cutting, agree to a standardized product for the lower price, and then come back the next day and say, 'but we want it to be done our way for the same price.' It's a cultural thing —they don't want to give up control."

One consequence of such troubled interactions is clear: Notes another Tier 1 executive, "I do see some suppliers starting to say 'no,' and we have discussions every week about it at very high levels." The result for the Big Three could be fewer choices among qualified suppliers and narrower options. Said a North American Tier 1 executive, "We're making a big effort at wooing the transplants, and we've been quite successful." Echoed a Tier 2 executive, "I'm looking at a transplant that is far more willing to listen to us."

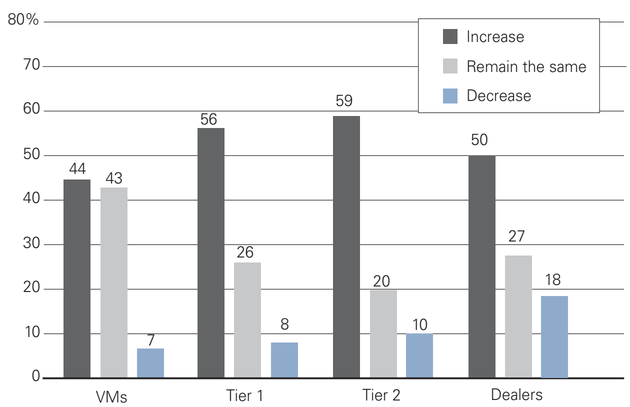
MORE CONSOLIDATION ON THE WAY

With the economic recovery starting to spark thoughts of increased risk-taking, executives believe the pace of mergers and acquisitions will increase.

One big stimulant is the delegation of cost savings down the value chain, which is prompting big suppliers to seek value and lock in margins via more complex products such as subassemblies. "We are primarily a Tier 1," said one North American executive, "but we're beginning to diversify and in some cases we're as far down as Tier 2. You're going to see more subassemblies going into manufacturing." Said another, "The movement from componentry to modularity is the biggest driver of M&A in the Tier 1/2 marketplace." This trend will help well-run Tier 1 companies prosper, but "smaller firms will disappear because they won't be competitive with the pricing required," predicted a Tier 1 executive.

Regionally, consolidation is expected to grow everywhere, but most dramatically in Asia (73 percent predict an increase there) and Europe (60 percent), with just half (50 percent) saying consolidation will increase in North America and 35 percent saying its rate will stay the same. As one might expect, consolidation is thought most likely to increase among Tier 1 and Tier 2 suppliers; also, half said consolidation among dealers will increase, while 27 percent thought dealer consolidation will stay the same. But only 7 percent thought the pace of consolidation will *decrease* among VMs, while the same proportion thinks it will increase (44 percent) as stay the same (43 percent). The underlying trend toward fewer VMs, then, is not expected to ease. Projected one non–North American Tier 1 executive, "I think OEMs are consolidating [to the degree] that we'll end up with five manufacturers worldwide."

Do you expect consolidation among the following types of companies to increase, remain the same, or decrease in terms of global market share over the next five years?



Source: KPMG LLP

Among all respondents, Tier 1 executives seem most attuned to increases in consolidation activity this year:

- Seventy-one percent expects more Tier 1 consolidation, compared to 32 percent of VM respondents.
- Fifty-nine percent anticipates more dealer consolidation, compared to 37 percent of Tier 2 respondents.

Also, North American respondents are more likely to expect consolidation growth in certain segments than their European and Asian counterparts:

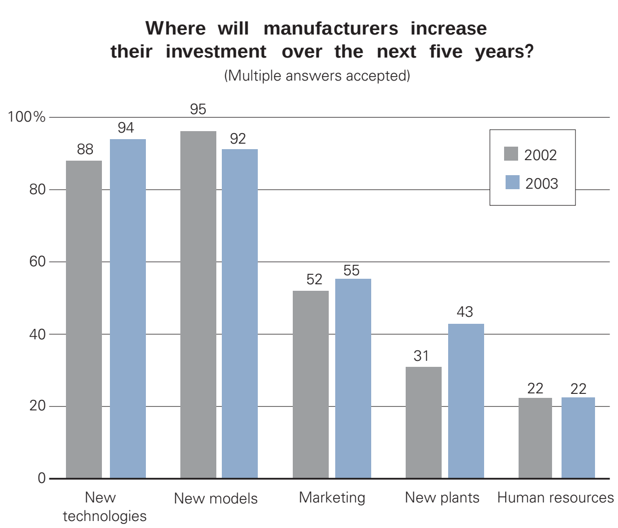
- In Tier 1, 72 percent versus 42 percent
- In Tier 2, 77 percent versus 43 percent

Toward future cooperative ventures, executives show continued cooling this year. In 2001, 83 percent said such ventures will be more important in the auto industry than mergers and acquisitions; that number slipped to 72 percent in 2002 and dropped to just 55 percent this year. Said one Tier 1 executive, "We tend to go on our own." Another observed, "Partnerships are pretty difficult. Someone always wants to be in charge." Echoed a Tier 2 executive, "I haven't seen partnerships work too well. Pretty soon they realize it isn't providing the benefits they originally expected."

Not surprisingly, executives surveyed see future consolidation as tactical rather than strategic—a response to immediate challenges rather than an opportunity for growth or company transformation. The top three drivers of consolidation are thought to be cost pressure (92 percent), lack of profitability (92 percent), and poor financial performance, followed by access to new markets (83 percent). But economic recovery as a driver, global or local, comes in last with 61 and 58 percent, respectively.

MORE NEW MODELS, DEMANDING CUSTOMERS

How to get consumers into showrooms and buying? As in 2002, executives agree almost unanimously that the answer is exciting new, technology-rich cars and trucks and that those two areas—new models and new technology—are where car companies will spend the most money. Executives recognize that the right new models will spur sales, and that trying to appeal to the broadest possible market with a relatively few models might not be the soundest approach. "What we have to do is focus on specialized models," said one North American VM executive. "We can't all make everything for everybody." In fact, many respondents pointed out, a growing class is small niche vehicles. "A European Tier 1 executive noted, "We're seeing here quite a growth in fancy small cars, like luxury coupes." A European Tier 2 said, "The Smart is a funky little car, but they are selling so many of them. People love them."



Source: KPMG LLP

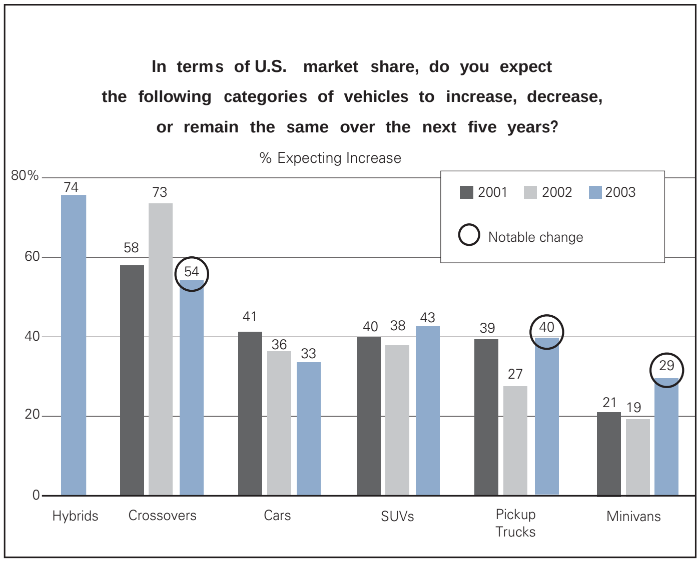
In terms of North American model mix, a large percentage—74 percent—thinks hybrids (added in 2003) will gain market share over the next five years, but from a level currently too low to register. Crossovers remain the largest non-hybrid category expected to gain share over the next five years, but the percentage of those expecting crossover growth dropped significantly, from 73 percent in 2002 to 54 percent this year. Third this year are SUVs, up slightly to 43 percent from 38 percent; fourth are pickups, up significantly to 40 percent from 27 percent; and fifth are cars, about the same (33 percent) as last year (36 percent). Minivans rose 10 points to 29 percent this year. However, differences in how North American and non–North American executives feel about the growth prospects of various vehicle types are significant in every category but cars. North American executives are more bullish about hybrids (89 to 60 percent) and crossovers (79 to 32 percent), while non–North American executives attribute more North American share growth to SUVs (57 to 28 percent), pickup trucks (49 to 30 percent), and minivans (45 to 11 percent). Taking these differences into account, the anticipated decrease in crossover share growth and the rise in share growth for pickups and minivans in North America are largely attributable to the bigger percentage of non–North American respondents this year.

In terms of the global market, executives also expect share growth for hybrids (73 percent), but more North American executives (87 percent) than non–North American (60 percent) believe this. Otherwise the model mix globally has a different complexion, with more growth for cars (48 to 33 percent for North America) and minivans (42 to 29 percent for North America).

MORE NEW MODELS, DEMANDING CUSTOMERS (CONTINUED)

In general, then, executives think that North America is likely to see more share growth in crossovers and, to a lesser extent pick-ups and SUVs, while cars and minivans will continue to decline; globally, they say all categories are likely to grow, but cars and crossovers could grow more than minivans, pickups, and—to a lesser extent—SUVs.

Luxury models—a new global category this year—tied cars for second place with 48 percent. Noted a North American VM executive, "For the foreseeable future, unless something catastrophic were to happen with the oil supply, the trend toward more luxurious vehicles will continue."



Source: KPMG LLP

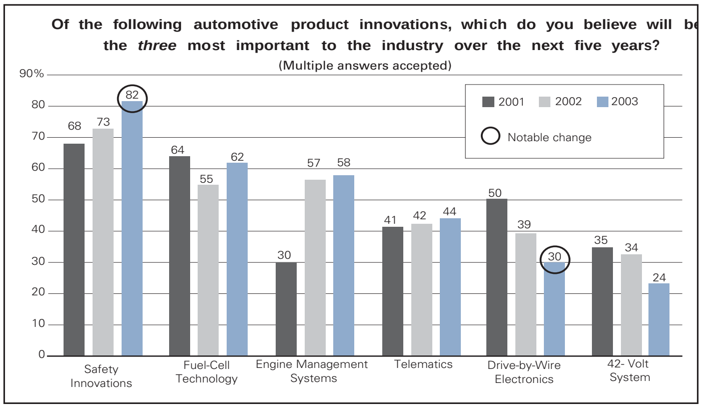
TECHNOLOGICAL INNOVATIONS THAT MOTIVATE CONSUMERS

When consumers opt for technology in the future, executives apparently believe, they will want the benefits to be palpable. Among six categories of technology, respondents again put **safety** first in importance over the next five years, and with growing enthusiasm—68 percent in 2001, 73 percent in 2002, and 82 percent in 2003. "The focus on safety and drivability will continue, like pre-crash sensors and pedestrian safety," affirmed a North American Tier 1 executive. "You won't believe the innovations that have been developed."

Fuel-cell technology remains number two in importance, rebounding to 62 percent from last year's 55 percent, which was down from 64 percent in 2001. Third is **engine management** at 58 percent, which maintained last year's big jump from 30 to 57 percent. Telematics stays unchanged in fourth for the third straight year at 44 percent. More telling, only 21 percent this year think that "telematics will have little impact on how people use and feel about cars," compared to 34 percent who dismissed telematics just last year.

But trending down since 2001 were **drive-by-wire electronics**, accompanied this year by **42-volt systems**. These beefed-up electrical networks, still in development, will help usher in the era of drive-by-wire—an era probably more distant than once supposed.

Nevertheless, many respondents think the importance of electronics is growing: 76 percent this year agreed that the proportion of a car's value composed of electronics will "increase dramatically"—the same figure as 2002 and off only slightly from 2001's 80 percent.



Source: KPMG LLP

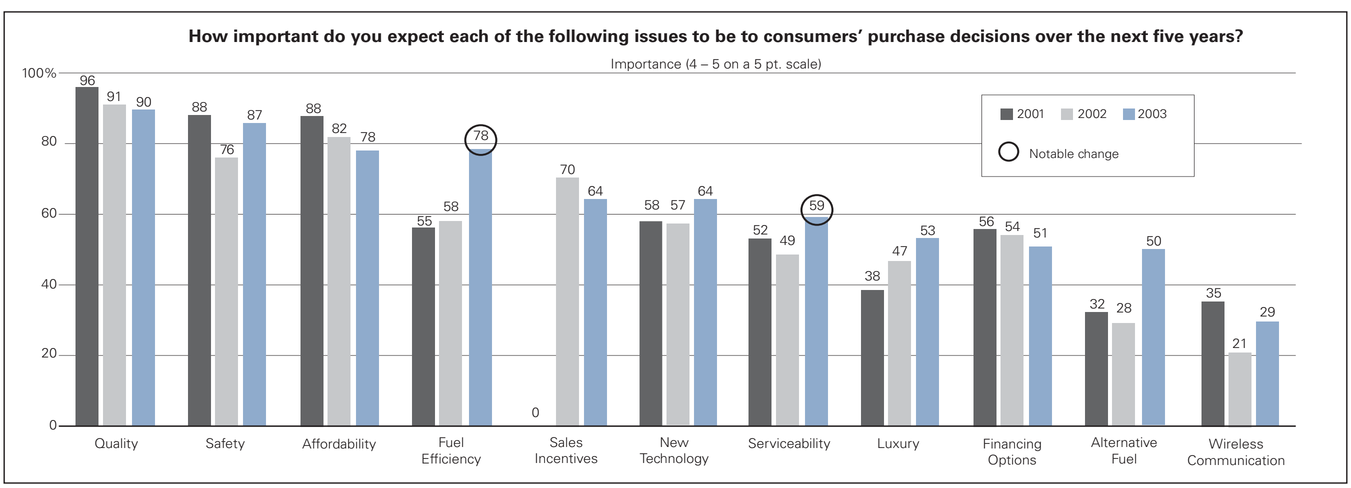
HOW CONSUMERS WILL CHOOSE

Executives believe consumers will continue to prize **quality**, **safety**, and **affordability** as the top three criteria in their purchase decision over the next five years, with slight adjustments in each: Quality is off a bit in importance from 96 percent in 2001 to 90 percent this year; safety rebounded from 76 percent last year to 87 percent in 2003, the same as 2001 (88 percent); and affordability edged down again, slipping from a high of 88 percent in 2001 to 78 percent this year. But the relative stability of these perennial leaders differs from significant changes in lesser criteria.

Fuel efficiency rose 20 points in importance this year to tie for third with affordability (78 percent), surely the most prominent position it has occupied the minds of automotive executives since the Carter Administration. "Business will be driven by the fact that we need to achieve better fuel economy," asserted one North American VM executive. But only 40 percent of respondents expected an increase in public concern that automobiles contribute to "poor air quality and global warming," the same as last year (41 percent). However, only 23 percent of North American respondents expected an increase in public concern while 58 percent of non–North American respondents thought such an increase likely. In view of the larger number of non–North American respondents in this year's survey, the sharp decline among North American executives who expect a negative public reaction to the industry's environmental stance this year is notable if not significant, and surely indicative of the continuing popularity of large, relatively fuel-hungry light trucks and big-engine luxury vehicles. Summed up a North American Tier 2 executive, "The trend is toward lighter cars and smaller engines, which give less emissions. But people aren't going to do anything unless it's regulated."

Sales incentives dropped slightly from 70 to 64 percent in expected importance, but not enough to suggest executives predict a sizable lessening of their impact over the next five years—indicative itself that the reliance on subsidies to move product may have become endemic in the industry. Indeed, they are starting to be offered in Europe, where sales have been soft in several countries this year. "Incentives are getting out of control and will flatten in a couple of years," said a North American Tier 1 executive. Many more agree this year: Only 38 percent expected an increase in the use of sales incentives in the near future, down from 48 percent in 2002 and 63 percent in 2001.

Luxury as an expected purchase-decision factor rose slightly in 2003 to 53 from 47 percent but the gain since 2001 is 15 points, underscoring observations elsewhere in this research that luxury is increasingly attractive and attainable. Noted one North American VM executive, "Right now, with financing incentives, I see more people buying high-end, luxury vehicles." And **alternative fuels** rose significantly in importance in 2003 from 28 to 50 percent. "The work being done with diesels [by European manufacturers] is impressive," noted a North American Tier 1 executive.



Source: KPMG LLP

CUSTOMERS GET WHAT THEY WANT OR ELSE

Between the post-war generation of loyal-for-life consumers and the typical consumers of today is apparently an unbridgeable gulf. For one thing there are no typical twenty-first century consumers. And loyalty to vehicle brands, service facilities, and dealers is slipping away—and likely to continue to do so, according to this year's executives, although at different rates. Worst is customer loyalty to dealers—54 percent thinks it will decrease over five years, up from 45 percent last year and 46 percent in 2001. Vehicle brands fare slightly better this year—only 41 percent thinks loyalty will decrease, down from 47 percent last year but still worse than 33 percent in 2001. For all three years, executives thought service facilities will experience the lowest decline in loyalty of the three industry customer-facing segments, but only by a slender margin, and the trend is toward more decline—from 31 percent in 2001 to 38 percent this year.

Clearly, executives think the industry can take less and less for granted where consumers are concerned. Urged a North American Tier 1 executive, "VMs need to be much more aware of what the consumer wants."

CONCLUSIONS: A LANDSCAPE OF CHANGE

From almost every point of view, executives feel the global car business is in dynamic flux. Among the strongest conclusions this year is an outgrowth of a consensus the two previous years —that Asian brands are ascendant and likely to continue so while U.S. brands will give up the market share the Asians gain. Where once the U.S. OEMs held their own with offsetting domination in big-margin light trucks and bread-and-butter minivans, success in the car business only guarantees that someone else will soon figure out how to top you at your own game—and not just more cheaply and efficiently, but with better quality and a more attractive, benefit-rich design.

This year all eyes turned to China, which many view with real hope as a reliable source of both future sales growth and low-cost manufacturing. A car-buying middle class numbering in the hundreds of millions could well materialize in China this decade, particularly if manufacturing migrates there as expected from North America, Europe, and elsewhere in Asia. Complained one North American VM executive, "My biggest concern is that, even with the most advanced technologies, we cannot compete with 32 cents an hour in China." And while that rate will rise with the standard of living, the gap between Chinese wages and North American wages and benefits, despite concessions in this year's labor agreements, won't close substantially for many years.

The good news is executives believe the recovery is here. The rest of the news is mixed. Fundamentally, the battle for market share continues to heat up. Competition is, if anything, intensifying. This means efficiencies must be found or invented and costs throttled back still more, and these pressures have to be shared across the supply chain, with the eventual result a period of mergers, acquisitions, and bankruptcies—a shakeout of sizable proportions, from which will emerge a few suppliers much larger with broader capabilities. And, increasingly, the industry from VMs well into Tier 2 is turning to outsourcing for new cost savings, with its attendant need for good inter-company relationship-management skills. If outsourcing includes arrangements with low-cost makers wherever labor is both cheap and productive, particularly in the developing world, this potential is only beginning to be exploited. But things can change quickly. Noted a North American VM executive, "Mexico continues to have strong potential [for manufacturing], but you have two hurdles there: energy costs and labor costs, both of which will escalate."

And consumers are likely to be ever more inscrutable. As they start to enjoy both the recovery of 2003–2004 and a car industry eager to seduce them with design razzle-dazzle, they will wield their newfound power freely. Adding to the challenge of pleasing them are rising expectations: What was rare and luxury class is now familiar; what was an extra-cost option is now assumed to be standard, at no uptick in MSRP.

This recovery, executives seem to indicate, won't be another heedless boom. Car buyers will be more informed in 2004 and beyond than during the late 1990s bubble and the shadow prosperity since. They will be more discriminating and patient, less willing to trust, harder-headed about price, and more interested in fuel efficiency than consumers have been in quite some time.

If there ever was an era when making money in the car business was easy, executives do not think the next few years will be another one.

Survey Methodology

Under the auspices of KPMG's Automotive practice, Applied Research & Consulting LLC (ARC) conducted 100 quantitative interviews with executives, 47 based in North America and 53 based in Europe and Asia. Of these, 81 worked for suppliers and 19 for vehicle manufacturers. In addition, ARC conducted 10 in-depth qualitative interviews with senior executives, 5 based in North America and 5 based in Europe. Of these, seven worked for suppliers and three for vehicle manufacturers. Findings from the two types of interviews show a high degree of correlation.

KPMG