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BLOG

Winter is coming: How prepared is the EU's auto industry?

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A number of initiatives have been taken recently in an effort to protect the environment and save it for future generations. The EU has also announced new emissions standards that all carmakers would need to follow starting 2020. According to the new rules, the emissions target for a passenger car will average 95g/km, phasing in for 95% compliance in 2020 and 100% in 2021. If a manufacturer exceeds this target, the penalty is EUR95 per g/km exceeding the target. The strict rules should help reduce the irreversible impact of emissions, but are likely to be a challenge for the entire auto industry – from original equipment manufacturers (OEMs) to suppliers to customers.

OEMs believe they can meet the targets by 2020, but average emissions were around 120g/km in 2018. To meet the targets, they would have to adjust their powertrain mix to include more electric vehicles (EVs), battery electric vehicles (BEVs) and plug-in hybrid electric vehicles (PHEVs). Carmakers would, therefore, have to invest in changes to production facilities that are less profit-generating.

OEMs and auto part companies spend about EUR54bn on R&D a year. With tighter regulations and increased demand for digital connectivity, they would need to increase this spending. They would also be heavily penalised if they fail to meet the required standards; the industry faces EUR39bn of penalties. These factors would be in addition to the global decline in sales and the trade wars.

The silver lining for manufacturers in this scenario includes super credits, cost reduction, partnerships and JVs, and consolidation. According to the super credit system, vehicles with emissions less than 50g/km will be considered as 2.0 vehicles in 2020, 1.67 in 2021, 1.33 in 2022, and 1.0 from 2023. Another way to lower average fleet emissions is via the "pool" option, where carmakers form emissions pools to jointly meet their targets. Fiat Chrysler Automobiles (FCA) has already joined hands with Tesla, and Mazda and Toyota are also forming a pool. In addition, manufacturers have formed JVs to combine their R&D capabilities. FCA and French multinational manufacturer of automobiles and motorcycles Groupe PSA have announced a merger to jointly meet the new targets. This shift in the industry is likely to foster more new partnerships and business combinations.

Demand for BEVs and EVs would depend on consumer buying behaviour. Customers may be wary of buying expensive vehicles. The extra costs that manufacturers may pass through to customers would lead to higher prices, reducing demand. OEMs may also have to face increased competition, especially from established EV producers that have a competitive advantage. To gain market share for their new vehicles, carmakers may resort to price wars in a highly competitive environment, further reducing profitability.

A major concern for customers is the availability of the infrastructure required for BEVs and EVs. One of the main reasons that customers are not fully convinced about embracing the new technology is the lack of proper EV charging stations. There are 144,000 such stations at present, of which 75% are in the Netherlands, Germany, France, and the UK. The situation is the same for fuel cell and natural gas vehicles. Therefore, all EU states need to expand their charging networks; it is estimated that Europe will require around 2.8m charging stations by 2030.

All EU countries would also need to encourage the purchase of new-technology vehicles. The market share of electrically chargeable vehicles (ECVs) is less than 1% in countries with GDP per capita less than EUR29,000 and 3.5% where GDP per capita is more than EUR42,000. Efficient incentive schemes would need to be put in place to reduce this disparity.

New challenges bring new opportunities. We believe the coming years will define the auto industry.

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