Analysis of PSA Group's takeover of General Motors Europe

by Matthias Holweg & Nick Oliver[1]

1. Industry Overview

The world's 25 major carmakers[i] face a difficult environment. The car industry suffers from long term **overcapacity** which squeezes margins. It is very exposed to economic cycles. Car companies need economies of scale to be viable. Markets are increasingly diverse and sophisticated, which means that many models are required, stretching engineering and other resources. In addition, the industry faces major **structural challenges** in terms of the shift to electric propulsion and the rise of autonomous vehicles.

Most industries respond to pressures like these by consolidation, with some companies making an exit and mergers and acquisitions amongst those that remain. Consolidation in the auto industry has been slow, perpetuating the overcapacity problem. This is a particular problem in Europe.

Nations who have a car industry try to retain it, and those that do not already have an auto industry work hard to attract new automotive investment. Car manufacturers are relatively large employers with regional significance, plus each worker in a car assembly factory typically supports a further 7.5 jobs in the wider supply chain[ii]. National and regional competition to attract and retain car-making is therefore an important industry dynamic. This is one reason why consolidation in the car industry occurs only slowly and sporadically, sustaining overcapacity and thereby depressing margins: **capacity is easily added during market in upturns, but not necessarily removed during downturns.** The result is an estimated 25% production overcapacity in the global automotive market (c.90 million units in 2016) which reduces financial returns for all players.

2. Why have PSA and GM Europe (GME) struggled in recent years?

Sales of both PSA and GME are very focused on the European market. Although the market has recovered considerably since the 2008 financial crisis, there is still considerable overcapacity.

PSA and GME models are direct competitors in the European market, largely in segments where several carmakers compete head on. There is **very little complementarity** and considerable duplication between their model line-ups. There are other European producers (VW, Renault and Fiat), as well as overseas competition from Japan, Korea and Ford from the US. Margins are particularly lean in the supermini, sub-compact and compact segments where PSA and GME sell the majority of vehicles.

Both PSA and GM are **'full-spectrum' operations**, which means they have the ability to design, develop, manufacture and distribute vehicles. GME benefits from access to GM's global engineering, financial and other resources.

[1] Matthias Holweg is a professor of Operations Management at Saïd Business School, University of Oxford, Nick Oliver is a professor of Management at the University of Edinburgh Business School. They are co-authors of *Crisis, Resilience and Survival: Lessons from the Global Auto Industry*, published by Cambridge University Press in 2016.

The table below summarises the profile of each firm.

	PSA Group **(Peugeot, Citroen and DS brands)**	**GM Europe** **(Opel and Vauxhall brands)**
Vehicle sales (in units, 2016)	3.15 million	1.16 million
Number of employees	172,000 worldwide	38,000 (incl. 18,000 in Germany, 4,500 in UK)
Number of vehicle assembly plants in Europe	11	6
Locations of vehicle assembly plants (models in brackets)	**France:** Mulhouse (Citroen C4, DS4; Peugeot 2008); Poissy (Citroen C3, DS3; Peugeot 208); Rennes (Citroen C5; Peugeot 508); Sochaux (Citroen DS5; Peugeot 308, 3008, 5008) **Portugal:** Mangualde (Citroen Berlingo; Peugeot Partner) **Slovakia:** Trnava (Citroen C3 Picasso; Peugeot 207, 208) **Spain**:Madrid (Citroen C4 Cactus; Peugeot 207) Vigo (Citroen Berlingo, C4 Picasso, C-Elysee; Peugeot 301, Partner) **Sevelnord, France (JV with Fiat),** Lieu Saint Amand (Citroen Jumpy; Fiat Scudo; Peugeot Expert; Toyota ProAce) **Sevelsud, Italy (JV with Fiat),** Val di Sangro (Citroen Jumper; Fiat Ducato; Peugeot Boxer) **TPCA, Czech Republic (JV with Toyota),** Kolin (108, C1 and Aygo)	**Germany:** Eisenach (Adam, Corsa); Russelsheim (Insignia, Zafira Tourer) **Poland:** Gliwice (Astra; Cascada**)** **Spain**: Zaragoza (Corsa, Meriva, Mokka) **United Kingdom:** Ellesmere Port (Astra); Luton (Vivaro)
Other manufacturing facilities	**France:** Douvrin (engines); Hermincourt (engines); Metz (transmissions); Tremery (engines); Valenciennes (transmissions)	**Austria:** Wien (engines) **Germany:** Kaiserslautern, (engines) **Hungary:** Szentgotthard (engines) **Poland:** ISPOL, Tychy, (engines)
Operating income (loss)	2015: € 1.98 bn; 2016: € 2.61 bn	2015: € (0.74) bn; 2016: € (0.24) bn
% sales in Europe	61%	100% (excl. vehicles for Buick and Holden)
UK market share in %, 2016	6.7%	9.3%

Source: Annual reports, company websites, SMMT, Automotive News, Wards World Motor Vehicle Data.

PSA Groupe (also known as Peugeot-Citroen) experienced a major crisis following the European car market collapse in the wake of the global financial crash of 2008. PSA has been through a restructuring and refinancing programme. PSA closed an assembly plant near Paris in 2013 as part of this restructuring effort. Since then it has heavily invested in new products, including launching a new brand the 'DS' brand. In 2014 the French Government and PSA's Chinese joint-venture partner Dongfeng both took a 14% stake in the firm, as part of a major restructuring and refinancing effort.

In a 2016 league table of the resilience of the world's auto companies, **PSA was ranked as the most at risk of 15 global car manufacturers**[iii]. Key reasons for this were its limited scale and market reach, being too exposed to the European car market.

GM Europe (GME) is the European arm of US car maker General Motors (GM). GM Europe is headquartered in Germany where most of its design, engineering and manufacturing operations are located, with additional assembly plants in the UK, Poland, and Spain. Its main brands are Opel and Vauxhall, who have been within the GM family since the 1920s. GM also owned Sweden's Saab from 1989 to 2010. Saab was sold off in 2010 and went out of business in 2011.

GM's European operations has been making losses since 2000, at estimated total cost of USD 20 billion. GM came close to selling GME in 2011 but came under considerable political pressure in Germany due to fears of job losses. GME closed a plant in Bochum, Germany, in 2014 to reduce overcapacity.

The European car market has **diverged considerably from other global car markets** in terms of consumer tastes and regulatory frameworks. Only 20% of GM vehicles currently produced in Europe are shared with other markets. At the announcement of the sale of GME on 6 March 2017 Mary Barra, GM's CEO, declared that GM's aim was to 'direct our capital to where we have the strongest brands', indicating that GM do not see Europe as having significant growth potential. Moreover, operational synergies between GM global and its European operation are now clearly limited. The sale of GMR will reduce GM's global scale and market reach, but will allow it to focus its effort and resources on more profitable markets and invest in new technologies.

3. Implications of the PSA-GME Deal

The takeover of GME by PSA raises the **fundamental question of whether it is possible to create one competitive firm out of two relatively weak ones**.

Operationally, the main options open to the new entity are to:

- **Consolidate central functions** (e.g. engineering, purchasing, distribution), reducing duplicate headcount in the head offices,
- Develop new vehicles onto **joint platforms**, thereby reducing development and manufacturing costs (PSA and GME have been collaborating on three joint platforms since 2012, for small SUVs and MPVs), and
- **Consolidate production** on those platforms into a smaller number of plants to improve capacity utilization. In short, we are likely to see Peugeot, Citroen, Opel and Vauxhall cars produced on shared assembly lines in future.

To improve the finances of the two operations, the combined company will need to achieve some combination of increasing volume by selling more units, selling the same number of units at a higher price, or reducing costs. Market conditions in Europe make the first option problematic. PSA has an operation in China, but is currently a weak player that arrived late in the Chinese market after an early false start. GM makes most of its profits in China and will seek to protect this position. (When GM sold Saab in 2011 it placed severe restrictions on the ability of Saab's new owner to operate in China). With regard to the second option, none of the main brands of the combined company (Peugeot, Citroen, Opel and Vauxhall) are premium brands, so opportunities for premium pricing will be limited.

By a process of elimination, this leaves cost reduction as the main avenue for improvement. The likely outcomes of this takeover are therefore:

- A **reduction of central functions** of GME in Germany, as engineering functions move to France
- **Closure of marginal plants**; those in the UK look particularly vulnerable, as are the plants in Portugal, Madrid in Spain, and Eisenach in Germany
- **Consolidation of plant capacity** in Spain (where both PSA and GME currently have plants)
- Creating **regional production centres** by vehicle size: consolidating production of mid-size cars in France and Germany, consolidating small car production in Spain, and moving supermini

production to Central and Eastern Europe. On the commercial vehicle side, the question is whether the SEVEL collaboration with Fiat will be renewed in 2019, which will determine the location of future commercial vehicle production centres.

Both French and German governments have stakes in and/or close connections to the PSA and GME, and hence **political pressures must also be factored in**. Carlos Tavares, PSA Group's CEO, was asked repeatedly about plant closures following the merger in the press conference on 6 March and insisted that existing union agreements will be honoured. This however only protects jobs in the short term, as most agreements will expire by 2018. In the long run he implied a process of internal competition between plants, using benchmarks of 'cost, quality and schedule adherence'. He stated that 'the only thing that really protects [a plant] is the right level of performance.' In short, each plant will have to compete for investment as existing models are retired and new ones come on stream. Tavares added that this was a 'competition', in the same way as the 'automotive industry is competition.'

A key question is whether the combined entity will be able to **move into developing markets**. Currently neither PSA nor GME have significant sales outside of Europe, so if they remain focused on Europe the emphasis is likely to be consolidation and cost-cutting. GM will be protective of its market share in China, now the largest car market in the world, as well as other key markets such as Russia and Latin America.

At the 6 March press conference, there was reference to 'strategic flexibility to grow outside Europe'. No further details were been given, but this will be key to the future of the merged entity. Establishing what precisely this will 'strategic flexibility' means and what form it will take is crucially important. As it stands, the merger will create one very large car maker that is very exposed to the mature, saturated European market: PSA sells 2 out 3 cars in Europe, GM Europe sells all of its cars here. It was PSA's dependency on Europe that led to its existential crisis of 2013. This deal could exacerbate the problem of being **reliant on a hypercompetitive, saturated market**.

4. What will this mean for the UK plants?

The UK plants have some factors that count in their favour and some that count against them.

Factors in their favour:

- **Flexible labour.** Ellesmere Port won the replacement Astra in 2014 on the back of a salary freeze, against Bochum, their German sister plant. The result was the closure of the Bochum plant.
- The **cost advantage** for direct manufacturing labour in the UK has been estimated to be around 30% compared to Germany, and up to 20% against France.[iv] We agree that the UK certainly is competitive in terms of labour cost, which is in part based on the weak Sterling exchange rate, however such currency fluctuations must be treated with caution. Investment decisions are not made on the basis of low exchange rate today, but on where the exchange rate will be over the life cycle of a model, which is 5-7 years. Currency fluctuations in general mean uncertainty, which is perceived as a risk, and thus, a problem.

Factors against the UK plants:

- An **absence of heavy-duty political support** and the **uncertainties of Brexit** both count heavily against the long-term prospects for the UK plants.
- Both French and German governments have **stakes** in and/or **close connections** to their national car industries.

- Brexit is creating many uncertainties, both in terms of the **customs union** and **access to the single market**. Potential tariffs for importing components from the single market, and for exporting finished vehicles back to the single market represent a risk of considerable significance. At present 59% of components for vehicles made in the UK are imported[v], while 77% of vehicles made in the UK are exported[vi]. Free movement of parts and finished vehicles to and from continental Europe in many ways is a key prerequisite for retaining a volume car industry in the UK.

The UK plants will only be viable if components move into the UK and finished vehicles out of the UK into the European market with as little cost and 'friction' as possible. It was interesting to note Tavares' views on 'soft' and 'hard' Brexit scenarios. Under a **soft Brexit**, the UK would remain in the customs union and have access to the single market. In this scenario, Luton and Ellesmere Port would compete for new products on equal terms with all other plants in the PSA Group.

Under a **hard Brexit**, the UK would likely face tariffs for importing components, and for exporting finished vehicles to the EU. Tavares' view was that under such scenario the UK could become a production centre for vehicles to be sold in the UK, thereby retaining both cost and revenue structures in Sterling. This would have the advantage of avoiding (some) tariffs and the risk of currency fluctuations. However, there are two problems with this scenario. First, the majority of components could not be sourced from within the UK due to a lack of suitable suppliers. Thus a significant proportion of tariffs would still apply. Second, it is unlikely that a single assembly plant could produce the diversity of models required in today's market in an economical way.

5. When are we likely to see the effects in the UK?

PSA made it clear that existing union agreements will be honoured. Plant closures are only be likely at the end of a model cycle, when production of the current model comes to and end and the location of production of a new one is decided.

For **Ellesmere Port**, there is unlikely to be any sudden change. The current Astra launched in 2015 and will run until 2021, so the decision of where to produce its successor is likely to be made in 2018.

Luton at present produces the Vivaro a Renault-based design, introduced 2014. A key question will be whether PSA will renew its alliance with Fiat to produce commercial vehicles. This agreement is due to expire in 2019, so a decision about Luton's future could be expected later this year.

6. Would plant closures in the UK affect Vauxhall's sales in the UK?

It is instructive to consider the effects of two recent plant closures in the UK. When PSA closed its manufacturing plant near Coventry in 2006, its market share dropped from 10.5% to 9.7%. When Ford closed its Southampton plant in 2013 (assembling the Transit van), its sales of medium commercial vehicles stayed virtually the same, dropping from 26.7% to 26.4%. Thus, based on these two recent cases, **UK plant closures and redirection of production elsewhere are not likely to provoke a strong adverse reaction in the UK market**.

Notes to editors:

To speak to Professor Holweg or Professor Oliver please contact the press offices:

Tom Pilsworth, Press Officer, Saïd Business School, University of Oxford
T: +44 (0)1865 288 879
M: +44 (0)775 327 76 89
E: thomas.pilsworth@sbs.ox.ac.uk

Derek Main, PR Manager, University of Edinburgh Business School
T: +44 (0)131 651 5310
M: +44 (0)7702 312523
E: derek.main@ed.ac.uk

About Saïd Business School

Saïd Business School at the University of Oxford blends the best of new and old. We are a vibrant and innovative business school, but yet deeply embedded in an 800 year old world-class university. We create programmes and ideas that have global impact. We educate people for successful business careers, and as a community seek to tackle world-scale problems. We deliver cutting-edge programmes and ground-breaking research that transform individuals, organisations, business practice, and society. We seek to be a world-class business school community, embedded in a world-class University, tackling world-scale problems.

About University of Edinburgh Business School

The University of Edinburgh was founded in 1582 and is one of the world's leading universities. The Business School has provided business education for nearly 100 years. Today it offers undergraduate, postgraduate and executive education programmes and provides a platform for research, discussion and debate on a wide range of business issues. As one of the leading business schools in Europe, the School comprises of an international student body representing more than 88 countries

Endnotes

[i] Defined as producing in excess of one million units per annum. Source World Motor Vehicle Data, 2016.

[ii] Holweg, M., Davies, P. and Podpolny, D., 2009. The competitive status of the UK automotive industry. Buckingham: PICSIE Books. http://www.innovation.jbs.cam.ac.uk/research/downloads/holweg_competitive_status.pdf

[iii] Holweg, M. and Oliver, N. (2016) "Crisis, resilience and survival: Lessons from the global automotive industry", Cambridge University Press. For more information on the benchmarking outcomes see: http://crisisresiliencesurvival.com/wp-content/uploads/2016/01/Resilience-league-table..pdf and http://crisisresiliencesurvival.com/resources/the-book/key-messages/

[iv] Figure based on 2012 data for manufacturing labour, source ILC. Analysis does not account for on-cost, productivity and is subject to currency fluctuations. https://www.bls.gov/fls/ichcc.pdf

[v] Holweg, M., Padgett, T. and Davies, P. (2015) "Growing the automotive supply chain: Local content analysis", Automotive Council UK. http://www.automotivecouncil.co.uk/2015/09/growing-the-automotive-supply-chain-local-vehicle-content-analysis/

[vi] SMMT "Motor Industry Facts and Figures" https://www.smmt.co.uk/2016/05/motor-industry-facts-2016/