Will Europe Finally Fix Its Auto Industry?

There was much jawboning last week at the Geneva auto show about the urgent need for Europe to finally address its auto industry's overcapacity problem. Western European factories are churning out far too many vehicles for too few buyers. Automakers don't dare close factories for fear of retaliation by their unions and repudiation by local governments. The situation has existed for years but is worsening with the deteriorating economy. Mass-market automakers like General Motors' Opel, Ford, PSA Peugeot Citroen and Fiat are forced to offer deep discounts to move the metal and continue to pay workers when assembly lines are idled, leading to untenable financial losses.

It seems, at last, something absolutely must be done. But will it?

Chrysler/Fiat CEO Sergio Marchionne long has sounded the alarm that a consolidation of auto companies and the closing of plants are absolutely necessary. In fact, Fiat is only one of two companies to have closed a plant in recent years, its plant in Sicily, which was no easy task. The other was GM, which closed its plant in Antwerp, Belgium. Marchionne, who now holds the rotating presidency of the European automobile manufacturers association ACEA, last week called on the European Union to oversee the rationalization of the region's auto industry – a rationalization that would "distribute the pain and suffering" across all the members. He suggested using existing EU funds for research and development as well as to help displaced workers.

Marchionne estimates 20 percent of Western Europe's car-making capacity – or about 3 million vehicles a year – needs to be shut down, a number with which other executives concur. "All of the car manufacturers have capacity problems — all of them," Nissan/Renault CEO Carlos Ghosn, head of the Nissan-Renault alliance, said in Geneva. The issue will worsen as Ghosn predicted Western European car sales will fall another 3 to 4 percent this year. Philippe Varin, chief executive of PSA Peugeot, agreed with Marchionne, endorsing a common policy in Europe to solve the overcapacity problem. ACEA Secretary General Ivan Hodac, likewise, said Europe needs an "EU-wide solution."

The overcapacity and desperate financial situation of some car makers are driving partnerships like the alliance recently announced between GM and France's Peugeot. GM will take a 7-percent stake in money-losing Peugeot. The two expect to save $2 billion in costs by leveraging their parts purchasing power and co-developing shared vehicle architectures and components in the next few years.

In Geneva, the two companies revealed little more about the alliance that is being received with intense skepticism by other auto executives and analysts because it doesn't address the bigger problem of overcapacity. GM Europe President Karl-Friedrich Stracke said in a briefing that the two companies will deal with their overcapacity issues separate from the alliance. With its plants operating at only 80 percent of capacity, Opel needs another "two to three months" before providing details on how it will do so. "We need to engage every stakeholder," he said. GM announced late last year that it is re-examining Opel, which has lost money for a dozen years, up and down the financial ledger. GM Vice Chairman Steve Girsky, the architect of the PSA-Opel alliance, said in Geneva that the deal with Peugeot is just "one tool in our tool box" to fix Opel, hinting there was more to come, though he didn't utter the words "plant closings."

The GM-Peugeot alliance likely is but the first of more to come, said Ghosn, who has led one of most successful and long-lasting mergers though it was met in 1991 with much skepticism because of the unlikely combination of a Japanese and French company. In addition, Renault-Nissan has alliances with Daimler in Europe as well as partners in Russia and India. Ghosn said the Daimler alliance was going extremely well and would help Renault move more premium, a segment that has not been as hard-hit as the mass market.

Marchionne made clear Fiat is shopping for partners. A proposed Fiat-Opel merger was blocked in pre-bankruptcy 2009 largely due to opposition from the governments and unions. Fiat had also been rumored to be talking with Peugeot, and GM's move blocked a Fiat-Peugeot alliance, though Marchionne insisted he would not want to trade places with GM. Yet, asked by a reporter if Fiat had talked with Sweden's Volvo, now owned by China's Geely, Marchionne said no – "but give them my phone number…We're talking to anyone." Marchionne said alliances are a matter of "cash preservation" as global automakers face the costly requirements to boost fuel economy, lower emissions, develop vehicles for global markets and generally leverage economies of scale.

Still, who is willing to blink first and close plants? Recalling how painful plant closings are having done it in the early days of the Renault-Nissan alliance said it won't be his companies. "It'll be led by the company that needs it the most, but if somebody restructures, it's going to force everybody to restructure," Ghosn said.

Marchionne pointed out that Europe is now in the same situation that North America was mid-decade. The "dysfunctional" behavior that resulted in as much as "$8,000 being attached to the hoods" of Chrysler vehicles in 2007 is a behavior now being repeated in Europe and one that leads to bankruptcy. Indeed, took a recession and the near-extinction of two of North America's three automakers – Chrysler and GM – to set the restructuring wheels in motion. But today, the U.S. auto industry is a major engine for the nation's economic recovery. Factory capacity now is in line with demand. Incentives are at their lowest levels in four years, boosting average transaction prices of vehicles, allowing automakers to post healthy profits.

North America illustrates the possibility for a healthier European auto industry. As was said in the U.S., it would be a shame to waste a recession by not taking action to fix the region's ailing auto industry.

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