CAN AUTOMOTIVE MANUFACTURERS HANDLE GROWTH IN LATIN AMERICA?

Automotive companies are poised to reap the benefits of increased business in the region—but first they must overcome some supply chain challenges.

Latin America holds huge promise for the global automotive industry, both as a strong consumer market (once markets like Brazil and Argentina surmount their current difficulties) and a source of production – but only if the region takes steps now to keep pace with growth.

The continent stands to benefit from several significant macro developments, including a shift of manufacturing from Asia to the Western Hemisphere, the economic stimulus impact of new trade agreements, and the relaxation of many tariff barriers. But countries throughout the region won't be able to realize their full potential without addressing a shortfall in transportation infrastructure. Roads, railroads, ports, and airports all require major improvements and new construction – at a time when the region's total investment in transportation has fallen to half the level of the past two decades, according to a report by the Economic Commission for Latin America and the Caribbean.

Mexico in a strong position, but challenges abound

Of all Latin American countries, Mexico appears to be in the best position to capitalize on the recent surge of automotive manufacturing in the region. Still, it faces a number of challenges, including those related to transportation, infrastructure, energy costs, and talent, which could block future success if they are not addressed soon.

The World Bank's Logistics Performance Index for 2014 ranks Mexico 50th out of 160 countries in terms of supply chain efficiency. Infrastructure is lacking in every node of the country's logistics network. On the maritime side, four major ports – two on the Pacific Coast and two in the Gulf of Mexico – handle 96 percent of the nation's container traffic, according to a report by The Seneca Group LLC for the U.S. Trade and Development Agency. All are operating at or near capacity. The government is seeking private capital for a doubling of capacity at the Port of Veracruz, but that project was delayed due to environmental concerns and will take two to three years to complete.

Many Mexican roadways remain deficient, having been starved of investment for decades. While some of the country's highways meet world standards, the overall system lags those of developed nations. Transportation delays persist, equipment shortages are common, and cargo theft on the roads is widespread.

An inefficient railway network keeps 85 percent of the nation's goods on the roadways. Mexico has seen some progress on the rail front in recent years, following the privatization and division of the rail network among three operators: Kansas City Southern, Ferrosur, and Ferromex, the last of which acquired Ferrosur in 2005 and is jointly owned by Grupo Mexico and Union Pacific Corp.

Mexico is home to 85 airports and 1,385 airfields, according to a report on the country's transportation and logistics sector by the consulting firm PwC. The system handles 80 million passengers and 700 million tons of cargo annually, but most of that activity is concentrated at just 17 facilities. Air is rarely an option for domestic shipments, given the ability of trucks to reach most points of the country within 48 hours.

Still, air transport in Mexico is projected to triple over the next 10 years, notes José Luis García, vice president of automotive, engineering, and manufacturing with DHL Supply Chain Mexico. He considers it crucial for Mexico to address its infrastructure shortcomings, which currently account for a total logistics cost of between 10 and 13 percent of the total manufacturing expense, compared with 6 to 8 percent in developed countries.

The cost of energy in Mexico is another potential obstacle to the growth of manufacturing in general, and the automotive sector in particular. After years of debate, the government is finally addressing the need for constitutional and legal reform in that area. It has opened the door for private capital to undertake exploration of new energy sources, in partnership with government-owned Pemex.

The issue of supply chain talent is paramount in Mexico. The median age of the population is 26.7, according to the U.S. Central Intelligence Agency's World Factbook, and while the country boasts a large number of engineers, it needs more individuals who have completed at least some university education or possess the right technical skills. In the automotive sector, they’re needed in such areas as the installation and maintenance of machinery, information technology support, and supply chain design.

High potential in Brazil and beyond

A separate set of challenges to industrial growth exists in Brazil, where supply chains confront a difficult geography, widely dispersed population, high fuel costs, and significant trade barriers. To automotive companies, however, the country offers a promising location for domestic production, which could spread beyond Brazil’s borders if trade restrictions are relaxed. Similar conditions and concerns exist in other countries throughout the region.

Up to now, however, such obstacles haven’t prevented dramatic growth in Latin America’s automotive sector. Triggered in part by the trend of “reshoring” production from Asia to the Western Hemisphere, the number of automobiles made in Mexico has increased rapidly over the last five years, topping three million in 2014, and is on track to reach five million by 2020, according to Datamonitor. A report by the consulting firm KPMG notes that production levels in Mexico grew by 65 percent from 1999 to 2011, and growth is projected to exceed 42 percent in 2016. Major U.S., Asian, and European automakers are responding with billions of dollars worth of new investment in plants throughout the country.

What automotive companies can do

It’s unlikely that Latin America’s potential as a source of automotive activity can be fully realized without major reforms in government policy and infrastructure investment. In the meantime, there are a number of actions that automotive companies can take to cement their future in Latin America.

For instance, many are cutting overhead by adopting lean principles and slashing inventory levels. This strategy is in large part a reaction to shrinking product lifecycles, which are driven by consumers’ preference for greater choice and variety. Traditionally, auto designers have observed development cycles spanning two to three years. The new target is a year or less.

With reduced inventory comes a greater risk of supply chain disruption. Manufacturers are seeking to mitigate the danger by expanding their universe of suppliers and assembly points. Instead of producing cars in one country and selling them around the world, automotive companies are moving toward dispersed production. Mexico is among the fastest growing regional nodes for the production of vehicles for export throughout the Americas and beyond.

As automotive supply chains grow in complexity, manufacturers face a corresponding need to simplify and centralize key responsibilities for overseeing their supply chain partners. García believes the challenges of making and moving product throughout Latin America are creating new openings for third-party logistics (3PL) providers to act as supply chain managers on behalf of manufacturers and suppliers. Their responsibilities might range from day-to-day operations to value-added warehousing, carrier selection, and network design.

Automotive manufacturers are betting on Latin America as the next big area of opportunity. As they grapple with the promise and perils of doing business in the region, however, their need for visibility, control, and expertise across all links of the supply chain have become more critical than ever.