

## Developments in the Korean Auto Industry

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For those following developments in the Korean auto industry, the first quarter of 2006 has certainly proven to be anything but mundane. Recent headlines have touted the further expansion of Hyundai and KIA's global production networks and the rising brand image being enjoyed by Korean automobiles. Not all of the news has been positive, however—despite strong sales, both KIA and Hyundai have struggled with narrowing profit margins, primarily as the result of an appreciating Korean won. Separately, an investigation has been launched into allegations against Hyundai of illegal lobbying.

### Globalized Production

Last year, Hyundai and KIA collectively produced 3 million vehicles domestically and more than 664,000 units abroad. Of the nearly 3 million vehicles Hyundai hopes to sell abroad this year, it plans to produce one third in overseas facilities. With an eye on breaking into the top five international automobile manufacturers by 2010, Hyundai-KIA continues to expand its global manufacturing facilities on three continents:

**North America:** Hyundai and KIA have begun production operations in the United States, with a goal of reaching North American sales of 1 million and 800 thousand, respectively, by 2010.

Alabama: Hyundai Motor's factory in Montgomery, Alabama began production in 2005, producing 91,000 cars. According to a recent *Korea Herald* article, Hyundai Motor Manufacturing Alabama plans to produce 275,000 autos in 2006 and 300,000 in 2007.

Georgia: KIA Motors recently announced plans to open a \$1.2 billion plant in West Point, Georgia, 80 miles from the Hyundai plant in Alabama. The proximity of the two Korean auto operations will allow them to share Korean parts suppliers that have settled in the area. The *Korea Herald* reports that KIA decided on the location in Georgia over contenders in Mississippi, Kentucky, and Tennessee after conducting a year-long feasibility study.

Meanwhile, while General Motors cut jobs in the United States by 9,000 from 2004 to 2005, it increased its Asian work force from 15,000 to 31,000 in the same period. According to a recent *Wall Street Journal* report, GM is losing market share in the United States while GM Daewoo sales have risen. Since GM Daewoo was launched in 2002, sales have increased from 0.41 to 1.15 million units per year.

**Europe:** In 2005, Hyundai and KIA sold, respectively, 357,000 and 240,000 cars in Europe. By increasing their Europe-based production capacity, they hope to double European sales to 1.1 million units by 2010.

Czech Republic: Hyundai Motor is to build a \$1 billion plant in the Czech Republic by 2008. The plant will likely be located near Ostrava, in northeastern Moravia.

Slovakia: About 60 kilometers from the Hyundai Motor operation in Ostrava is the KIA Motors facility in Zilina, Slovakia. Construction of the facility was completed in September 2005, and production is expected to begin in December of 2006.

Russia: The *Chosun Ilbo* reported that Hyundai Motor has agreed to a \$2 billion deal with Russia's Rostovskiy Zavod Gruzovih Avtomobiley (RZGA) to produce 77,000 commercial vehicles by 2010. Under the agreement, Hyundai will supply parts for buses and trailers, and RZGA will set up the assembly facilities. Hyundai hopes to triple its current 5% market share of Russia's commercial vehicle market by 2010.

### Asia:

India: In a 2005 press release, Hyundai Motor Chairman and CEO M.K. Chung explained that Hyundai Motor India will "serve as one of our key global manufacturing centers." When the construction of Hyundai's second facility in Chennai is complete, the production capacity of its facilities in India is expected to be 400,000 vehicles per year, which will be sold in Europe, Latin America, and the Middle East, as well as India.

China: Hyundai continues to boost the production in its Chinese-based facilities, and is building more factories there. KIA is producing 430,000 units annually in China.

### **Rising Brand Image**

Japanese vehicles sold in the United States are generally priced higher than similar Korean models, and they currently occupy all ten slots of *Consumer Reports*' top picks for 2006. *Business Week* reports that Hyundai is "spending like crazy," raising its research and development budget to \$1.75 billion in 2005, more than twice the 2002 level. Hyundai is betting that the revamped Sonata and Santa Fe and the new Azera luxury sedan will give the brand a boost. Hyundai and KIA offer 10 year/100 thousand mile powertrain warranties that are unmatched by U.S., European, or Japanese automakers. Another development was the naming of Hyundai's Sonata as the best family sedan in a survey by PBS "Motorweek" for the 2006 Drivers' Choice Awards. Hyundai expects to boost the number of high-value vehicles sold in the United States, through its operations in Alabama. The *Joongang Ilbo* reports that U.S. production of Hyundai vehicles valued at \$30,000 or greater would increase from the expected 30,000 this year to 150,000 units in 2010.

### **Rising Won Squeezes Margins**

Although Korean auto manufacturers global sales climbed 10.8% last year, as reported in *Business Week*, its operating margins have narrowed, and profits fell by nearly a third in 2005. Hyundai officials assert that the decline in profits is the result of a strengthening won. South Korea's currency is more than 20% stronger than two years ago, and about twice as strong as it was immediately after the 1997 financial crisis. The pressure on margins occurs as U.S. auto manufacturers are offering large discounts and the Japanese yen is weakening. In order to cut costs by a target 10%, Hyundai has begun renegotiating contracts with suppliers, and over 8 thousand managers have accepted a freeze in wages. Hyundai Group also hopes to improve profits by focusing on producing high-end models in the United States and continuing to shift the production of compact vehicles to plants in India, reports the *Joongang Ilbo*.

### **Lobbying Allegations**

With prosecutors investigating lobbying allegations, Hyundai Automotive Group has cause for concern about how the legal issue may affect its credit rating by Standard and Poor's or Moody's, and the sentiment of foreign investors. The *Korea Times* reported that the prospects of a downgraded credit score could lead to a drop in Hyundai and Kia Motors stock prices and challenges in attracting investment.