

# Eastern Europe hangs in the balance

Following rapid growth and considerable investment, the markets in Central and Eastern Europe were among the most promising for European logistics providers. But will investors be able to hang on during the tough times? **Piotr Switalski** reports

In the 20 years since the fall of the Berlin Wall and subsequent crumbling of the Iron Curtain, the automotive industry has made impressive progress in the markets in Central and Eastern Europe. With an ongoing shift of production capacity from Western Europe to the region, particularly in the Czech Republic, Slovakia and Poland, as well as the emergence of a middle class, the region has represented “greener pastures” for an automotive industry that has reached the saturation point in Western Europe. And with the considerable infrastructure and service gaps between Europe’s two former halves, the opportunity and the need for logistics service providers have been great.

But the financial crash, while not quite threatening to rebuild any ideological walls in the region, has certainly knocked growth back by a good five years. In comparison to incentive-bloated markets in Western Europe, sales to the east and south of Poland have been grim, particularly in Russia, the Baltics, Ukraine and other newer EU entrants, such as Hungary, Romania and Bulgaria.

According to Christian Zbylut, regional CEO for Eastern Europe, Russia and Central Asia at Gefco, his company saw an overall drop of 50% in volume for finished vehicle logistics in those markets.

At DB Schenker the overall drop of 30% in volume amounted to “a tsunami” according to Axel Marschall, responsible for all DB automotive-related rail traffic.

While LSPs in Europe have recently been focused on capacity management, cost reduction and control, as well as the necessity of diversifying business, the collapse of markets in Eastern Europe has amounted to something like the routing of an advancing army on the second front of a war. There is simply no where else in Europe for providers to turn for growth. As Frost & Sullivan analyst Andriy Ivchenko points out, LSPs “have exhausted literally all possible solutions and pulled all the levers to survive the tough times as they face ever increasing pressures on margins from OEMs.”

## Investing for beyond the tough times

And at least for now, the CEE markets are no longer the brighter side of the coin. Rather, they have become a drain



DB Schenker had a 30% drop in overall volume following the financial crash

on some LSPs that invested so heavily in them recently. The question going forward, perhaps, is how long they will be willing to wait and how much more they will invest before the growth returns?

For DB Schenker, the situation has been particularly dire since some of its most important customers, premium carmakers, were not aided much by the incentives. Also the incentives, coupled with the relatively favourable costs of road transport (at least for the short term), lead to an increase in truck transport.

Several OEMs in Europe have admitted to making such short-term shifts to road. Suzuki's European plant located in Hungary saw the use of railway transport drop from 30% to 20% according to Csaba Bánki, head of export for Western Europe. As a result of this drop DB Schenker parked rail cars, renegotiated contracts with suppliers and even shifted some emphasis to trucks. Marshall maintains however that the company was still able to expand its overall network capability.

Network expansion had been the main strategy in the automotive logistics markets of Central and Eastern Europe recently, and in some instances it has contributed to a positive overall performance for companies even in the past year. Veli-Matti Pärssinen, managing director at Autolink Finland and responsible for the Baltic states and Russia, sees a bright side to his company's ongoing development in the region, which has been largely developed as a transshipment point for onward shipments to Russia. "I would see overall the last 12 months as a successful period for us due to our growth strategy."

Pärssinen believes that it is important to keep developing in promising markets even if they might be floundering at the moment. "Baltic countries have been a headache for all and we saw a drop of 80% in volumes for Latvia," admits Pärssinen. "However, we are almost there when it comes to our aim to be the leading provider in the Baltics and we definitely will be ready when the markets pick up again, capitalising on our increased involvement in this region."

When this pick-up of CEE markets might occur is a highly debated topic, some pointing to the end of 2010 as a possible time frame. Poland's car market has been stable thanks to a large home market and the domestic focus of the Polish economy. However, the Baltics will be slower to recover, according Pärssinen.

"They don't have exports to pick them up. Various industries and commodities picked up various European markets [such as the case of Sweden's paper exports helping logistics providers]. Yet in the Baltics something must be happening in the neighbouring countries, especially Russia. And Russia is a big question mark."

### When the sleeping bear wakes up?

Russia is indeed such a big question mark that it requires a separate focus, however it cannot be left out of any analysis of CEE markets because of its influences on the strategies of OEMs and LSPs across Europe. As Frost & Sullivan's Ivchenko confirms, there is speculation there will be some sort of financial car purchasing incentive in Russia for 2010. While the extent of the scheme is still unclear, most believe that it



will favour vehicles produced within Russian borders, which would reduce even more the car volumes flowing in from outside the federation.

Major Auto Trans' CEO Alexander Zhuravlev explains that although his company does not plan to withdraw from international operations, it has redeployed part of its fleet to increase its capacity within Russia. This development might add further challenges to the already difficult market conditions for both manufacturers and logistics providers.

### A long, slow recovery

Most would agree that financial incentives for new car purchases in Western Europe have padded the automotive industry's fall across the continent. Ford was among those that saw benefit. "We did our work before, investing in new products, which customers are keen to get," says Bert Bong, Ford's European manager for vehicle logistics. "We could partly offset the reduction in overall demand by increasing our market share and getting a bigger piece of the smaller pie."

The effect has been felt also in central and eastern regions where some of the vehicles that saw the highest demand increase were being produced. However, there is concern about the "hangover" that is likely to follow the end of these schemes.

On paper, the first quarter of 2010 should look good when compared year-on-year if only because the first quarter of 2009 (Q1) was so disastrous. However Q2 and Q3 are



## REGION CENTRAL AND EASTERN EUROPE

likely to be worse than this year. Production levels for small cars should carry on similarly in 2010, while medium and large cars may not bounce back in terms of volumes anytime soon – although the premium segment will feel no incentive “hangover” and could thus stabilise sooner.

“Overall we expect the levels of 2008 to return in 2011-12,” says Gefco’s Christian Zbylut.

The prospect of a slow recovery in mature markets has also forced BLG Automobile to explore extending its reach into markets fairly new to the company. The Port of Bremerhaven saw throughput drop year-on-year from 2m vehicles down to 1.2m in 2009. BLG’s Heinrich Averwerser explains that with volumes unlikely to recover quickly, the decision was taken to invest in Eastern Europe. “In these regions the market has high development rates, and is not yet divided up completely between few large players,” explains Averwerser. Furthermore, he adds, the price margin conditions are more favourable than in the highly competitive western markets.

### Price, price, price

There has been constant adaptation to fast changing conditions and transport routes over the past year. Delivery times were put under more pressure and quality of service has become even more of a differentiator between competitors, according to Christian Zbylut. Yet all agree that while price, quality and lead-times were always the three factors for contracts, the price factor has become the driving force behind new tender processes.

“In this crisis OEM invitations to tenders have actually been more and more of a market research tool,” states Averwerser. Armed with this market information of how low can prices be driven down, OEMs put long-term contracts in place with crisis time levels of pricing requirements. For example, prior to the downturn OEMs have negotiated contracts stipulating that the price per car shipped would go down as volumes increased, a normal business strategy when it comes



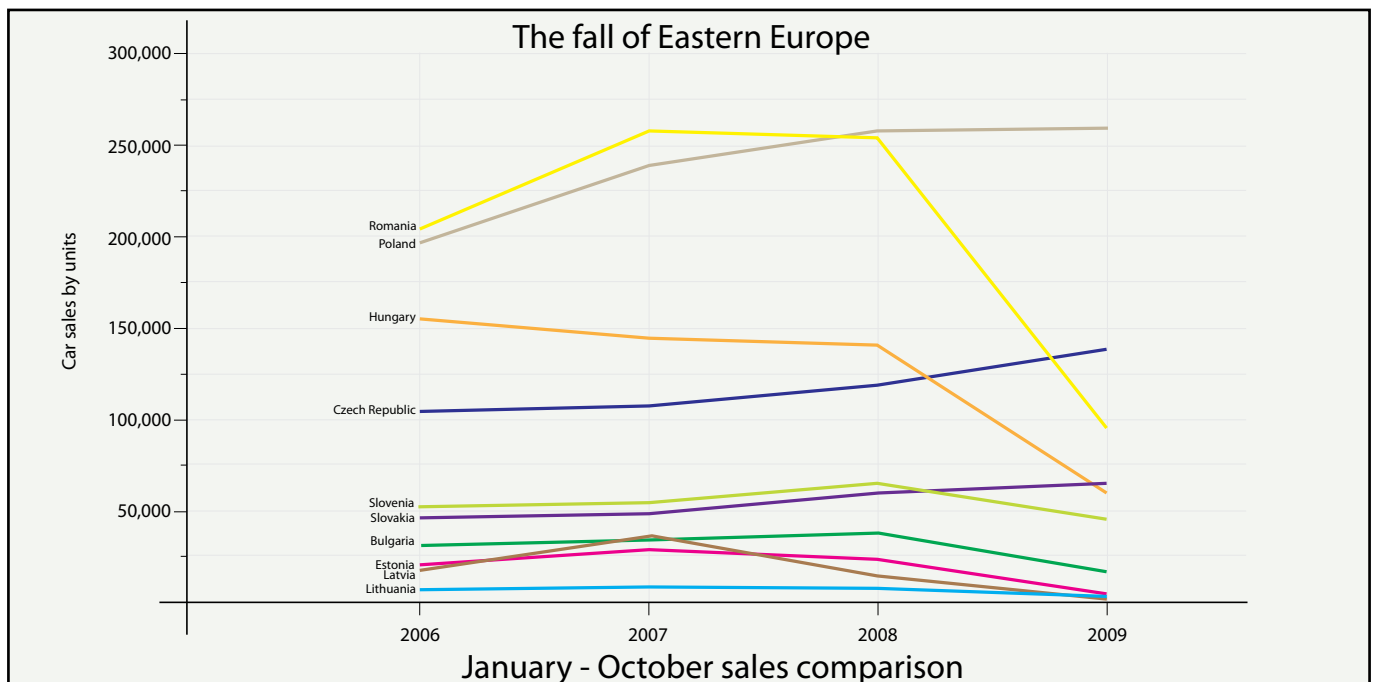
Gefco expects that 2008 vehicle production levels will not return until 2011-12

to economies of scale. However, in at least one instance this magazine has been told that some OEMs are negotiating for lower prices per unit as the volumes go down, threatening to take business somewhere else. This despite the fact that lower volumes led to poorer efficiency levels, with more empty backhauls and higher costs per unit for providers.

It is also worth noting that while the cost of service has in general dropped with the lower cost of fuel, it is not the case universally. In the Czech Republic, for example, the price for vehicle logistics has gone up in the last year, according to Ivchenko, because of highway toll collection and gasoline surcharges. The end result has tended to mean that LSPs are being held hostage on price in good and in bad times.

### Sounds like a broken record

The reoccurring topic within the automotive logistics industry, no matter what the financial conditions, has been the relationship between the clients and their providers. When it comes to short-term collaboration and transparency the LSPs agree that OEMs have a difficult time predicting volumes accurately in the current conditions. While new IT solutions and more integrated systems ensure better





There could be problems ahead if the disproportionate service model in CEE countries (where 20% of LSPs carry 80% of the volumes) does not gain more balance

capacity management, the call for recognising the integral role of logistics in the larger scale strategies of car manufacturers goes largely unrealised. What providers would like to see is more visibility from the OEMs when it come to both their mid-term production plans as well as for products.

Axel Marschall points to the example of carmakers in Slovakia and Central Europe that are expected to increase small car production in 2010. DB expects a pick up in the volumes stemming from the Volkswagen Bratislava plant, for example, where the new Up family of small cars will be manufactured. An OEM’s decision to build a line of potentially popular vehicles is important as it impacts the logistics flows.

In some instances longer-term volume forecasts are also being shared, according to Ford, but in the last year and a half these were changing nearly every week. “Ford shares long- and mid- and short-term forecasts but obviously in the last 12 months manufacturers and service providers had to react in a flexible way to fast changing demands,” says Bong.

**The day after tomorrow**

LSPs and OEMs could have used this time of low volumes for building future strategies better, especially in the still maturing Central and Eastern Europe markets.

“It seems that OEMs have been a little irresolute in these times. That is not to say we are blaming them, since they have massive problems of their own,” states Pärssinen.

Looking at the larger picture of the eastward expansion of the vehicle logistics industry this magazine wonders how much of the growth strategies will be driven by opportunism and how much will be in sync with wider OEM strategies. While the optimistic outlook of the unsaturated markets suggests there will be opportunity, the possibility of OEMs and LSPs moving forward out of stride from each other remains a distinct possibility given the current lack of

transparency and collaboration.

Although the pre-crisis volumes in the CEE region were growing at very impressive rates, the servicing of these markets was partially conducted by small and local players with little or no long-term experience. “It became a hit-and-run situation. Therefore a long-term collaboration is absolutely critical to developing operations in these markets. After this crisis, better times will come. Yet after that, surely there will come worse times again,” points out Pärssinen.

An ongoing development of a disproportionate service model is shaping up in CEE countries, where 20% of companies handle 80% of volumes, according to Ivchenko. “Everyone is experiencing hard times, but small and medium sized companies are hit the hardest, especially in CEE countries. These providers will feel hardest the squeeze on margins, where they will not be able to sustain their business in the longer run.”

**Being big acts as a buffer**

Larger providers with a diversified offering that operate in many countries with OEMs have had and will have an easier time. However this is also dependent on the length of the contracts and how developed the relationship is with the OEM. When it comes to future outlooks for the central and eastern regions, several trends seem to emerge. For product, the tendency remains toward smaller cars, which is forecasted to rise in production here relative to Western European production. But there also remains much potential to improve delivery networks, including where OEMs might look for co-loading opportunities, according to Ivchenko.

More fundamentally, the downturn has put even more pressure on providers in saturated markets to find more business; at least some companies have recognised that this may be the last chance to invest in a region in Europe where potential is not fully realised. Autolink’s Pärssinen states, “We are gearing up for when the markets pick up again; the hay day will come.” That hay day might not come as soon or as quickly as the region’s recent growth had suggested. And while the dynamics of the Russia market are still difficult to predict, over the long term the investment and hope put in Central and Eastern Europe are unlikely to have been in vain. ◀

**THE RUSSIAN FALL**

**Vehicle sales in Russia by unit**

Jan-Oct	2008	2009
Cars and LCVs	2,492,794	1,232,514 (-50.5%)