AUTOMATION NO LONGER ON AUTOMATIC

A QUIET SECTOR FACES DISRUPTION

The industrial automation sector has contributed to productivity increases and work safety for many years. As a result, the sector has expanded faster than most other sectors, and players have experienced significant growth at fairly high profit levels. Trends such as digitization, globalization, and changing customer requirements will lead to continued market growth — but they will also pose a challenge to established players' business models.

The industrial automation sector has grown significantly over the past years and is expected to continue to grow significantly until 2020 (at a compounded annual growth rate of more than 6 percent), to overall revenues of more than €200 billion. A deeper look into the development of industrial automation players nevertheless reveals some interesting insights. German firms, renowned throughout the industry as leading-edge technology players, have in many cases lost share to Asian players, and more importantly have seen lower profitability levels (~9 percent from 2008–2014), as compared to other European, North American, and especially Asian players (22 percent from 2008–2014, see Exhibit 1). With a few exceptions, Asian players such as Keyence, Fanuc, SMC, and Inovance have outperformed German manufacturers.

MEGATRENDS WILL ENCOURAGE AN INCREASED COMPETITIVE DYNAMIC

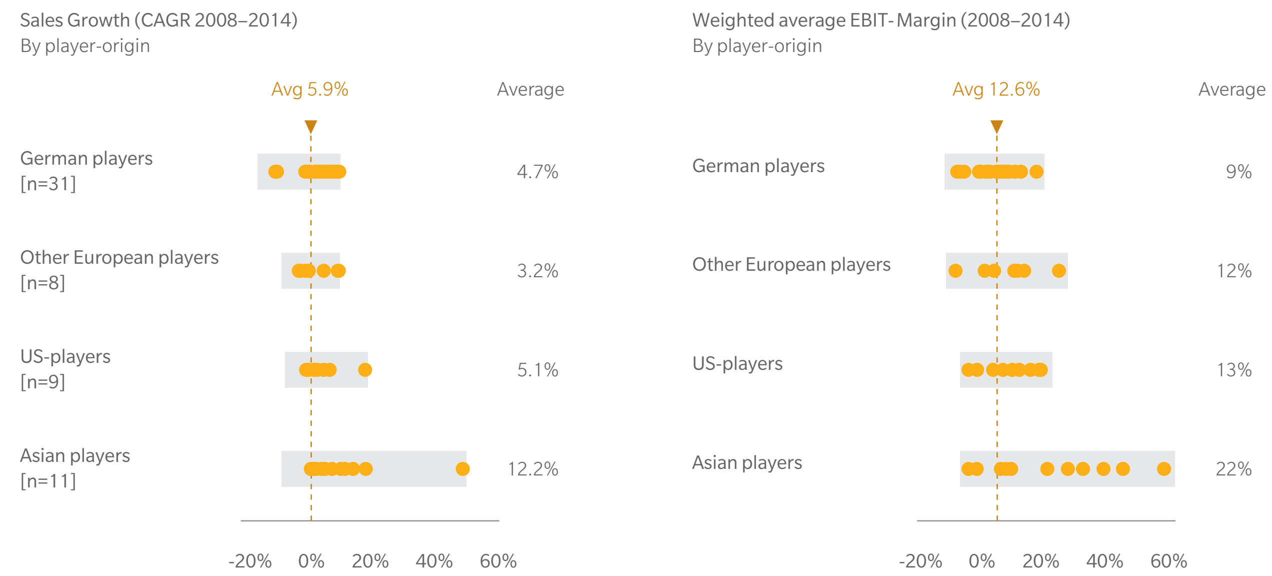
The industrial automation space has long been a sector where most players experienced growth and profitability and where trends have not been disruptive. In addition, competition was fairly restrained as compared to other industries. This allowed players time to steadily develop their portfolios and business design. However, this is likely to change as the challenges grow. Yet the level of competition will depend on each company's position in the very heterogeneous market, and will vary by business design archetype and segment covered. We expect an era in which weaknesses in business design will be revealed and exploited more quickly.

Some of the developments and moves are likely to include the following: First, there will be a dynamic towards horizontal and vertical integration and a shift in strategic control points. These developments are all results of the current digitization and Industry 4.0. It will be critical for incumbents to maintain strategic control and broaden their offering, respectively. At the same time, challengers or leaders in adjacent industries such as Product Lifecycle Management (PLM) and Enterprise Resource Planning (ERP) will try to take advantage of this trend.

+22%
AVERAGE EBIT-MARGIN FROM 2008–2014 OF ASIAN AUTOMATION PLAYERS

Exhibit 1: Regional differences
Performance in industrial automation varies greatly, with Chinese firms particularly successful

PLAYER PERFORMANCE BY ORIGIN DIFFERS SUBSTANTIALLY



Note: Sales ranges: Germany (€18 MM–€19 BN); other European (€400 MM EUR–€18 BN); US (€96 MM–€13 BN); Asian (€206 MM–€5 BN).
Limited availability of financial data for some companies (not all years are available) – differing coverage of financials (average EBIT-margin based on different year).
Source: Oliver Wyman analysis

Second, "product to solution" has been a trend for many years, but one can observe an increased dynamic of medium-size players, especially drive technology providers, to really get there, as those players are well aware that their current position is at risk, and they may need additional scale to succeed in the future.

Third, "fit for function" has been a trend ever since the emergence of China as a growth market. Nonetheless, many European players have not found the optimal recipe to enter the market. One could expect a second wave of mergers and acquisitions (M&A) in emerging countries to address this issue and at the same time to enhance the often European-centric footprint. This is a step that many medium-size players have struggled with for a long time.

ROBUST BUSINESS DESIGN AND SCALE ARE ESSENTIAL

While overall market development is positive, automation players will need to find answers to key strategic questions that are related to ongoing and emerging trends. They will need to redefine their business models to exploit profitable growth opportunities.

For full liners such as Siemens, ABB or Schneider, finding the appropriate business design to take advantage of digitization and maintain strategic control will be the key priority.

For many medium-size players, the degree of challenge will vary. But in general, we see strategic challenges in such areas as completion of product/solution portfolio, building scale, and creating a footprint to address globalization.

Not all challenges can be addressed organically. Consequently, we expect to see a surge in partnership and M&A activity.

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