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D00730

ID

Distr.
LIMITED

ID/WG.41/BP.1
CD/PME(69)18

25 June 1969

ORIGINAL: ENGLISH

United Nations Industrial Development Organization
Organization for Economic Co-operation and Development - Development Centre

Expert Group Meeting on the Role and Promotion of Subcontracting in Industrial Development

Paris, France, 6-11 October 1969

SUBCONTRACTING IN THE ARGENTINE CAR INDUSTRY [1]

by

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[1] The views and opinions expressed in this paper are those of the author and do not necessarily reflect the views of the secretariat of UNIDO. This document has been reproduced without formal editing.

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INTRODUCTION

Argentina's car industry is a particularly noteworthy example of the way in which subcontracting arrangements between car assembly firms and their suppliers can be used for speeding up the industrialization of a country.

Before 1959 Argentine industry played only a small part in the automobile sector. There were only one or two assembly lines in existence in the country and the factories were mainly concerned with the manufacture of spare parts for imported vehicles.

But Laws No. 14,780 and 14,781 of 1959, by offering many advantages to investment from abroad, encouraged the manufacture in Argentina of vehicles which had previously been imported.

In particular, this legislation gave customs protection to all goods manufactured in Argentina by new industries on condition that the integration of their production adhered to the programme laid down by the State.

Thus, during the first few years of their existence, the assembly plants were able to carry on importing many of the parts that they needed, but the number was soon reduced by regulatory decrees. From 7 per cent of the FOB value of vehicles in 1965, the proportion was reduced to 6 per cent in 1967 and to 5 per cent in 1968 for private vehicles; percentages for commercial vehicles have remained higher.

After 1959, approximately twenty makes of car were authorized to set up assembly lines in Argentina. At the same time, the sales of vehicles assembled in Argentine increased swiftly and reached 194,536 units in 1965, including 34 different models of car and 32 commercial models.

But beginning in 1966 sales stopped increasing and fell back slightly. In 1968 an improvement has been noted and the annual average should be in the neighbourhood of 190,000 vehicles.

To keep up with the fast rise in orders and to integrate production at the rate fixed by the law, the assembly firms have had to seek the co-operation of small and medium-sized firms either as suppliers or as sub-contractors. 1/

In fact, the assembly enterprises have never carried out more than a third of the manufacture in their own factory, and most of it has been farmed out to other firms.

Thus at the end of 1968 the car industry in Argentina included approximately:

10 assembly plants;

2,000 small and medium-size enterprises, suppliers or subcontractors to the above.

This paper, compiled following an enquiry conducted by the Investigation Centre for Methods and Techniques in Small and Medium-Sized Enterprises (CIME) of the National Institute for Industrial Technology (INTI) with the aid of:

The Under-Secretariat of State for Industry;

The main car assembly plants in Argentina;

Twenty heads of firms selected from amongst the suppliers or subcontractors of these plants;

sets out problems which have arisen during Argentina's experience in sub-contracting and the solutions which are at present being applied or are desirable.

We have limited ourselves to the automobile sector because it is most representative both of the effects of the Law of 1959 and of the systematic use of subcontracting.

1/ A supplier manufactures his own products and distributes them through his own distribution network. A subcontractor, on the other hand, works on orders from other firms, carrying out a process on their behalf or manufacturing individual parts.

I. SUBCONTRACTING AND ASSEMBLY PLANTS

Subcontracting offers such advantages to assembly firms that the latter are making increasingly systematic use of it.

In Argentina car assembly plants found it particularly advantageous.

First, it permitted foreign car manufacturers to establish plants in the country without having to make all the necessary investments for establishing the integrated production systems demanded of them.

It enabled manpower and plant already in existence in Argentina to be fully utilized swiftly within the flexible framework of small and medium-scale enterprises.

At the same time it saved assembly plants from having to bear the burden of market fluctuations alone, by permitting them to pass on to the subcontractors the technical difficulties and the financial cost of the various modifications introduced into the manufacturing programmes.

Lastly, it was possible to keep down the cost of newly manufactured parts as a result of the relatively low fixed costs of subcontracting enterprises.

However, the subcontracting system was not without its drawbacks for the assembly plants.

The first difficulties between manufacturing enterprises and suppliers arose from delays and irregularities in the delivery of parts. Often the two disadvantages were combined because rejects compounded the delays.

To counter this, quality control departments at assembly plants had to perform the difficult task of specifying to subcontractors the standards to be met, and sometimes to assist them in applying these standards. These requirements, which were new for Argentine industry, had profitable results for enterprises accepting the discipline involved.

To meet the difficulties, several of them purchased licences in order to benefit from technical assistance given by foreign enterprises and thus achive quality of an international standard.

Others managed to establish such effective quality control of their own that the assembly plants could rely on them completely.

Moreover, most of the subcontractors previously working more or less on a workshop basis became accustomed to working to industrial standards.

Alongside the work of quality control departments, some assembly plants granted their subcontractors technical assistance in the form of visits by engineers, invitations to visit the assembly plants, and courses conducted by their own staff.

But prices remain the most delicate problem for assembly plants and subcontractors.

The cost of Argentine car components is much higher than that of European or American components.

1968 prices for vehicles manufactured and assembled in Argentina are about double European prices.

This places the Argentine car industry in a weak position, within the country itself as well as on the world market, where it is scarcely competitive.

The purchasing departments of assembly plants have therefore been systematically trying to make subcontractors lower their prices.

They work partially by persuasion, discussing with the heads of enterprises the establishment of their manufacturing costs, and partially by utilizing the pressure of competition or threatening to import parts from Europe or the United States within the percentage levels allowed by the law.

The general assessment by the assembly plants of their subcontractors is that while they have been satisfied with the quality of the parts being delivered to them in 1968, they nevertheless consider that their prices are still too high.

Relations between assembly plants and their subcontractors vary according to their traditions and the respective managements.

The two most extreme attitudes are either a deliberate attempt to subject the subcontractors to competition or, on the other hand, to choose the best subcontractor or subcontractors and co-operate closely with them.

Although in reality policies are not that clear-cut, positions adopted by the major firms can be traced back to one or other of these two attitudes.

II. SUBCONTRACTING AND SMALL AND MEDIUM-SIZED ENTERPRISES

The introduction of subcontracting in the automobile industry was not simply the result of a deliberate decision by the contracting factories to use the system but also of the special circumstances imposed on them by the Argentine State when it gave permission to a large number of foreign firms to establish plants in the country.

Since there were too many of these firms for them to be absorbed by the internal market it became difficult for each of the new enterprises to make investments, opportunities for amortizing invested capital being limited.

Therefore necessity, as much as policy, led the assembly factories to utilize Argentine industry for manufacturing the parts which they required.

The first enterprises that offered themselves were naturally those which had already been manufacturing spare parts for imported vehicles. The change in their market was generally beneficial to them since previously they had been working without any concern for quality.

Other enterprises which became involved were those working in other branches of industry, for example those manufacturing household electrical appliances, railway vehicles or agricultural machinery. These enterprises found in the passenger car sector a rapidly and steadily developing market offering orders of a more or less regular nature spread over the whole year, whereas their previous markets had been more subject to uncertainties and irregularities.

New enterprises also emerged, set up to manufacture vehicle parts which up till then had been imported.

All such firms had to make great efforts in order to adapt to the methods and quality requirements of the car industry. Some of them were obliged to drop out; but those which overcame the obstacles benefited from the industry's remarkable development and the different forms of assistance rendered it by the State, particularly through protective tariffs.

Thus, out of 2,000 subcontractors at the present moment working for the car assembly plants, it can be said that most of them originated in small firms, numbering no more than 10 workers 10 or 15 years ago.

It is also noteworthy that the expansion of these enterprises has most frequently taken place under the control of someone who was originally a skilled worker. During the enquiry it transpired that the managers or owners of 15 out of every 20 enterprises were workers who had set themselves up at their own expense with the savings of their families or friends.

These firms were normally too small initially to benefit from external assistance. They therefore obtained plant and equipment little by little using their own funds and/or credits advanced by machinery suppliers. Later on, when they had reached a certain financial standing, they availed themselves of the various types of loans advanced them by the banks, but always with a great deal of caution.

Unfortunately their investments were carried out in a haphazard manner as and when orders from the assembly firms came in, with the result that the different subcontractors participating in the same manufacturing stages are now often over-equipped. The plant surplus plus the fall-off in sales has meant that a portion of the plant available works at less than 60 per cent of its total capacity.

There has never been any attempt at co-ordinating investments on the part of either the assembly plants or their subcontractors.

It is true that a horizontal subcontracting system has grown up among the subcontractors themselves, but only on an empirical basis and only for certain specific jobs like painting or heat treatment. There have never been any central agencies for subcontracting, for example, to rationalize the purchase and utilization of machinery.

More often than not, therefore, the heads of small and medium-scale enterprises have succeeded in reaching their present industrial level through their own efforts alone.

However, in spite of the advantages enjoyed by subcontractors in the automobile sector, they have encountered and are still encountering certain difficulties with the contracting enterprises.

The difficulty most frequently mentioned by the subcontractors in their comments is the insufficiently large batches ordered from them and the very large number of different parts comprising the orders. These two factors prevent them from planning their activities ahead and from lowering their manufacturing costs as they would like.

The subcontractors are well aware of the demands of the market but they consider that technical and commercial studies should make possible a reduction in the range of products and more accurate forecasts.

Furthermore, they think that batch orders placed are small because some assembly firms deliberately give orders to a number of subcontractors simultaneously to keep them competitive.

They admit the need for competition but would like it to be limited to a number of more qualified enterprises which would then receive larger orders for each type of product.

Finally, the subcontractors consider that terms imposed on them by the assembly plants are often hard and that settling up periods are too long and place an undue burden on their reserves.

In fact, the opinions of the subcontractors about the assembly plants vary according to the extent of the relations they have with each of them.

Some of them are closely linked to single clients, but most of them, in order to safeguard their independence, try to maintain ties with as many assembly firms as possible.

III. SOLUTIONS: ADOPTED OR ENVISAGED

Despite its imperfections, the system of subcontracting used in the automobile sector in Argentina has been an important factor in the country's industrial development.

But this development continues to encounter difficulties which could have been avoided had certain measures now being adopted or envisaged been foreseen at an earlier stage.

First of all, it is estimated that of the twenty or more enterprises which were originally permitted to set up assembly plants in Argentina no more than ten are still in existence in 1968. And this elimination process has not taken place without social and economic repercussions. The subcontractors working for enterprises which closed down found themselves in a difficult situation and some of them were obliged to cease operations as well.

The spare parts market also raises problems, since it is competed for by parts or products manufactured according to standards imposed by the car manufacturing firms themselves, parts or products manufactured without quality control by enterprises selling low-price products, and finally parts or products manufactured by enterprises which may or may not hold licences but which are attempting to gain a foothold for their brands both by virtue of quality and by commercial action.

The subcontractors working for assembly plants, having managements more industrially than commercially oriented, enjoy only a small share in this market although it is much larger than the assembly components market.

Usually, the only way that subcontractors have any access to the former is via dealers with concessions from the assembly enterprises, who sell on the market spare parts of the same standard as those used in vehicle assembly. In fact, the same parts, manufactured by the subcontractors and bought at the same prices, are used either for assembly or for supplying the market with spare parts.

The situation of the subcontractors is therefore currently as follows. On the one hand they do not have the advantage of the large profit margins available to assembly firms in the sale of spare parts, and, on the other hand, access to the spare part market, which would mean that they could increase the length of production runs and thus reduce their costs, is partly impossible because the spare part market is open to low-price products which are not subjected to quality control and offer considerable profit margins to dealers.

But in the long run, if the subcontractors can establish a reputation for their products (through high-quality work and publicity), they can sell both on the spare parts market and on the components market.

Some enterprises manufacturing batteries, or brakes, are cited as examples but most of these are products which carry the name of a foreign brand with an international reputation, manufactured by the Argentine enterprise under licence.

However, certain Argentine firms in existence are already trying to establish their own brand names and introduce them to the internal market or to the international market.

The difficulties encountered by the assembly plants and the subcontracting enterprises have already been partially solved.

As noted above, the subcontractors have made a considerable effort to improve quality. A large number of them have even established their own quality control arrangements, enabling them to sell to the assembly plants with 100 per cent guarantees.

On the other hand, the assembly plants have made efforts to improve the terms of their orders and shorten invoice settlement periods.

Thus, in 1968 firm orders have normally been one or two months ahead and provisional orders two to three months ahead.

At the same time, outstanding bills have been settled within 90 days.

Moreover, the assembly enterprises have made efforts to establish a climate of confidence with their subcontractors. Some of them organize receptions, others invite subcontractors to visit their factories, and yet others reward [illegible] attesting the quality of work done by their suppliers.

Despite these efforts [illegible] it seems that the subcontractors still have a great need for information. They would like assembly firms to take them more into their confidence regarding sales and manufacture programmes. They would then [illegible] information and would be able, in addition to [illegible] more accurate manufacturing [illegible] investments with greater foresight.

This need for information is [illegible] by the anxiety displayed by certain subcontractors over the intentions of some assembly firms to employ subcontractors in [illegible] countries of the Latin American Free Trade Association.

This development has raised a number of problems. Should they continue their present activities or not? Have they the resources to manufacture commodities complementary to those which will be manufactured in other countries belonging to the Latin American Free Trade Association? And can they make investments in or furnish technical assistance to the other countries?

Questions of this kind can be answered only in so far as not only the assembly firms but also institutions and the State can provide the necessary information to these types of firms.

This shows that improved relations between assembly plants and subcontractors is not simply a bilateral affair, but depends also on assistance from business associations and the State.

Aid of this kind is already quite significant. Thus business associations publish regular statistics on the development of the automobile industry in Argentina and the world.

Similarly the Association of Argentine Automobile Manufacturers is studying how certain vehicle parts could be standardized for all vehicle makes manufactured in the country.

For their part the public authorities [illegible] to assist assembly plants and subcontractors [illegible] them in improving their relations.

The Labour [illegible] of [illegible], [illegible], [illegible] their authority to arbitrate in differences which may arise during quality control checks.

Elsewhere, assistance [illegible] by the State to basic industries (e.g. iron and steel, and the [illegible] industries) [illegible] import requirements and the need to plan for purchases of parts from outside Argentina. A large number of subcontractors would like [illegible] of this kind to be reinforced, either by [illegible] quality products on the Argentine market at competitive prices or by authorizing imports without unduly high customs duties.

All action and assistance of this kind will have its full effect when the current improvement in the economy begins to stimulate the internal market for cars.

No matter how favourable current prospects are, however, subcontractors in the car industry can no longer hope to maintain the high profit margins which they have enjoyed during the last 10 years.

This is why their present policy is directed not only towards widening their clientele among the vehicle assembly plants, but also towards seeking other commodities and other markets which they could utilize their investment and experience to the full.

This new approach does not run counter to the interests of the assembly plants, however, for the latter's main object is to lower the cost of their vehicles, which they can only do if their subcontractors reduce their fixed costs by making their machinery work at total capacity, i.e. either by making vehicle parts in long production runs or by supplementing the current short runs by turning out other items.

Thus, thanks to the subcontractors in the automobile sector, Argentina now possesses a large group of enterprises, of a high technical level, ready to cope with the next stage in its industrial development.

In the view of the management of these firms, their future will depend primarily on their own efforts and imagination, but they readily concede that sooner or later they will need assistance in the form of credits, sales information or laboratory and consultative services so that their enterprises can adapt to the changes which the next phase will require.

When asked from whom they expect such assistance, their answers most frequently mention the various institutions of the State. However, their desire to remain independent makes them likewise consider solutions planned and applied jointly with other industrialists.

Thus, after having undergone an experience in vertical subcontracting schemes, Argentina would appear to be ripe for an experiment in subcontracting of a horizontal nature, establishing an inter-industrial service enabling small and medium-sized industries to achieve joint solutions to problems which they would not be capable of solving with their own resources alone.

On balance, the results of Argentine experience in subcontracting within the automobile sector have been clearly positive.

However, the results achieved would seem to have been due to a large extent to the favourable conditions prevailing in this country, namely:

- a relatively large market in terms of both the number of inhabitants and their purchasing power;
- the particularly highly skilled Argentine labour force and the ease with which it assimilates modern techniques.

Unfortunately these conditions may not be met with to the same degree in other countries trying a similar approach.

For this reason, an awareness of the difficulties encountered by Argentina and the solutions which have been introduced or are envisaged there should be of considerable [illegible] to them.

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