Wheels of fortune

The threat of US tariffs has disrupted supply chains for car manufacturers while regulatory uncertainty over emissions fines poses other challenges. Which companies are in pole position to benefit? Lisa Lange, Justin Bazalgette and Shoa Hirosato assess a market in flux.

Setting the scene

With the EU planning to phase out fossil fuel vehicles in 2035, and a significant shift from internal combustion engine (ICE) vehicles to electric vehicles (EVs) already underway in China,[1] car manufacturers are under pressure to improve their EV offering,[2,3,4] or be prepared to compete in more congested ICE markets elsewhere. Either way, market share, profitability and long-term financial value will be affected. EOS's engagement is focused on topics that in our view will help to enhance and protect the long-term value of each auto company.

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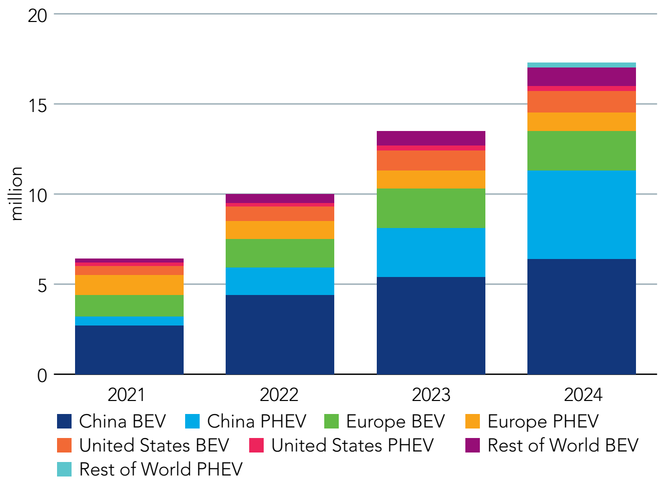
The electrification of private transportation represents one of the biggest shifts in the history of motoring, but with some car manufacturers lobbying for more time to phase out their ICE models, the adoption of EVs has seen several false dawns. Where governments have provided the right incentives and rolled out charging infrastructure at pace – as in Norway – EV take up has been rapid and widespread.[5]

However, outside certain niche markets, there are still significant headwinds, particularly for legacy automakers. The threat of US tariffs and weaker ICE phase out regulations in key markets have introduced fresh uncertainty for manufacturers, providing a disincentive to launch new EV models. In the UK, for example, the sale of hybrid vehicles will now continue until 2035, versus a previous deadline of 2030, with lower punitive fines for automakers missing targets.[6] Several planned investments in battery factories have also been deferred or cancelled in the UK.

[1] China is driving an electric vehicle revolution. But is it good news for the climate? | Euronews
[2] Agreement reached: Volkswagen AG positions itself competitively for the future | Volkswagen Group
[3] 25,000 jobs at risk at Stellantis plants in Italy - World Socialist Web Site
[4] Mercedes-Benz plans to cut 25% of workforce costs in China by 2027, source says
[5] https://www.bbc.co.uk/news/articles/cg52543v6rmo

Trends in electric car markets



BEV = Battery electric vehicle. PHEV = Plug-in hybrid electric vehicle.

Source: Global EV Outlook 2025, International Energy Agency

US, European and Japanese automakers must compete on EV production costs with their South Korean and Chinese rivals, which are now targeting overseas markets with attractive models at competitive prices.[7] In some cases, these EVs are more affordable and have proven track records.

Although the European Commission is yielding to pressure from European carmakers this year by giving them a three-year window to meet carbon emission targets, and thus avoid crippling fines, this may allow foreign competitors selling EVs into the EU to accelerate away from European players.[8 9 10] Recognising this challenge, the EU is holding strategic talks with companies, to help the sector improve its competitiveness.[11]

There is plenty to play for. While some press coverage has focused on the headwinds experienced by European EV manufacturers and suppliers in 2024, global sales were up more than 20% year-on-year, driven strongly by China.[12] This growth has continued, with Q1 2025 sales up 35% versus Q1 2024. The International Energy Agency (IEA) forecasts that sales of EVs will triple by 2030, with battery and hybrid models accounting for over 50% of cars sold globally.[13]

HOW US TARIFFS ARE RESHAPING THE GLOBAL MARKET FOR ELECTRIC VEHICLES

The threat of punitive tariffs on Chinese EVs sold into the US market, weaker emissions standards, and the possible removal of green tax credits granted under the Inflation Reduction Act could significantly dampen EV demand in the US, leading to increased supply into the EU.

Chinese EV manufacturers are already making substantial inroads into the EU, where higher profit margins allow them to remain competitive despite tariffs. China's BYD outsold Tesla in Europe for the first time in April, amidst a consumer backlash. European manufacturers have focused on exporting high margin, luxury brand ICE cars to China, but this market is shrinking as Chinese consumers turn increasingly to more competitively priced home-grown EV offerings.

Meanwhile, Japanese manufacturers have begun shifting production from tariff-affected markets to sites within the US. For example, Honda, which markets around 80% of its Mexican output to US consumers, is moving production of its flagship Civic model from its Mexican and Japanese factories to its Indiana plant.

6 EV targets watered down to help tariff-hit UK car industry
7 The electric vehicle revolution is running out of steam
8 https://www.reuters.com/business/autos-transportation/eu-propose-giving-automakers-three-years-meet-co2-emission-targets-2025-03-03/
9 Stellantis Could Make Fewer Gas Cars to Avoid Emissions Fines
10 Volkswagen Fears Colossal Emissions Fine is Coming
11 EU to Hold Strategic Talks to Revive Automotive Industry | EV Magazine
12 Are Global EV Sales Really Slowing Down? | BloombergNEF
13 IEA bullish on electric vehicle sales in 2024
14 Chinese carmakers reset European ambitions as EU tariffs bite
15 China's BYD outsells Tesla in Europe for first time, report says | Reuters
16 https://jp.reuters.com/business/autos/4KWP5ZPTURLODC7K2XDCTWKZIM-2025-04-16/

Our engagement on EVs and emissions reduction

Which companies have the most robust strategies to capture the growth opportunities in the EV market? One way for investors to assess how committed companies are to electrification is to look at how quickly they plan to cut fleet emissions. To this end, we have encouraged companies in jurisdictions with strong regulatory support, such as the EU and certain Asian markets,[17] to strengthen their EV strategies. This can be achieved by preparing for more ambitious scenarios and setting 1.5°C Paris Agreement-aligned emissions reduction targets to take advantage of climate-related business opportunities.

We also engage on how companies use their influence to lobby for supportive public policy, both directly and through their trade associations,[18] and ask them to make clear how their climate targets and strategies are incorporated into their financial accounts.[19]

In Europe, we have engaged with companies on setting emissions reduction targets and developing an electrification strategy. BMW, Mercedes, Volkswagen, Renault and Stellantis now have externally validated 1.5°C Paris-aligned targets for their Scopes 1 and 2 emissions, and targets of well below 2°C for their Scope 3 emissions. We are engaging with these companies on the business opportunities of adopting a 1.5°C Scope 3 target; this was hampered by a pause in validation by the Science Based Targets initiative (SBTi). Companies are now assessing how to address a shift in SBTi guidance, and indications are that they will submit new targets for Scope 3 when their current validation expires.

BMW, Volkswagen and Mercedes already publish regular reports on their association membership and lobbying activity. Our engagement is now focused on closing the gaps between their current disclosures and the global standard for responsible climate lobbying.[20] We engaged several times in 2024 with Stellantis and Renault on their first public policy advocacy reports, which were published in the first quarter of 2025.

All five companies include a description of their climate assessments and the impact of their climate targets and strategy in their financial statements. The impact has been limited to date, as companies are adapting their manufacturing lines to accommodate all engine variants. This reduces the capital investment required and the risk of redundancy as components such as the chassis are the same.

How Chinese EVs make inroads

Chinese automakers, led by BYD and Geely, have achieved considerable success in the global market due to low-cost battery production and strong domestic demand, which is driven by generous government incentives. In our engagements with BYD, we observed a gap between its EV production and its climate considerations; the company lacks climate targets and disclosure on its strategy, despite the significant positive environmental impact of its products. The company has yet to align its climate-related reporting with international frameworks such as the Task Force on Climate-Related Financial Disclosures to ensure that stakeholders are informed about its climate-related risk management.

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17 Subject to local laws and regulatory requirements
18 German automotive engagement on climate lobbying | Federated Hermes Limited
19 Public Engagement Report Q1 2023 | Federated Hermes Limited
20 2022_global-standard-responsible-climate-lobbying_APPENDIX.pdf
21 From Honda to Toyota, Japan's Carmakers Are Losing Ground to China's BYD, Geely
22 EV shift could pose a big challenge to Japanese economy | Oxford Economics

We also engage with BYD on risk management in its vertically-integrated supply chain due to environmental and human rights concerns. We encourage robust due diligence processes, and transparency. South Korea's Hyundai Motors has also enjoyed success with its EV strategy and responded positively to our engagement on validating targets and improving its climate-related disclosures.

In Japan, we have encouraged 1.5°C-aligned Scope 3 targets and have asked automakers to address disclosure gaps for better transparency. Honda responded positively by disclosing its medium-term emissions intensity targets in 2023. However, despite pioneering vehicle electrification technologies and strong hybrid sales, Japanese automakers face significant challenges due to Chinese competition.[21] Large-scale production of next-generation EVs by Japanese companies is not expected in the short term.

The Japanese auto industry is closely intertwined with the established supply chain for ICE and hybrid vehicles, which complicates the transition to EVs.[22] Toyota plans to leverage its hybrid expertise and adopt a multi-pathway strategy, including hybrids for markets without a developed EV infrastructure, and catering to conservative consumers. Meanwhile, Suzuki has significant market share in India, which has a national net zero goal of 2070. We have encouraged Suzuki to increase its ambitions to align its emissions targets with the goals of the Paris Agreement. We will continue to monitor the development of its alternative low-carbon technologies for rural areas with limited EV infrastructure, where it plans to expand.

In other emerging markets, Chinese competition is increasing where Japanese companies have historically dominated, such as in South-East Asia. Given these challenges, we have focused on transparency in climate policy lobbying, as Japanese automakers are members of influential industry bodies. In recent years some companies have enhanced their climate lobbying disclosures, with Toyota publishing several standalone reports following shareholder action. In our engagements with Toyota, Honda, and Suzuki, we encourage further alignment with the global principles of responsible climate lobbying.

Engagement themes for the automotives sector

Engagement Theme	Drivers of long-term value[23]
Climate Opportunities	• Investing in new EV production lines, worker training, and materials supply networks can impact the value of a company's assets and its capital expenditure. • Investing in intellectual property around EV drivetrains, platform configurations, power, and production methods could impact company assets and R&D expenses. • EVs are experiencing growing penetration rates in major auto markets, albeit at different rates. Automobile manufacturers can harness these tailwinds, but it will require a multi-market strategy that increases the level of difficulty. The growing market will present sales growth opportunities for companies that can effectively navigate the timing of the transitions in their main markets.
Greenhouse Gas Emissions	• Emissions standards and other related regulations may necessitate a shift from existing ICE models to lower emission and non-fossil fuel vehicles. These changes could manifest in the form of required new capital investment, operational cost structure changes, and different product input costs. In addition, a changing product mix and different market expectations could have an impact on the marketability of the product range.
Safe Products and Services	• Automobile safety is highly regulated, and EV products specifically introduce safety elements via their battery packs, with which companies are less experienced. The industry has seen many instances of costly recalls over the years that have long lasting implications for financial health. Addressing product safety issues requires a number of stages. First, the company incurs direct recall/remediation expenses and sales halts, followed by potential regulatory and legal actions that manifest as expenses and liabilities. Finally, as safety is a major consideration for automobile customers, the damage to brand image can have a long and lasting impact on sales volumes.
Employment Terms and Conditions	• Addressing demands for higher wages due to labour market forces, as well as pressures from organised labour, specifically around periods of union formation and collective bargaining negotiation. Attracting and retaining skilled manufacturing workers, and negotiating material increases in wages during collective bargaining, can drive significant changes to operating expenses. • The high prevalence of labour organisation in automobile manufacturing presents the ongoing risk of work stoppages, especially during periods of collective bargaining negotiations. Work stoppages can lead to extended periods of lost sales for automobile manufacturers, which can flow upstream to suppliers.

Source: Federated Hermes.
Table compiled by Luke Fleisch, ESG Analyst, FHI

[23] Non-company specific drivers of long-term value

Engaging on other risks for automakers

While automotive companies are now launching integrated, universal vehicle platforms to accommodate different powertrains and car models for the EV transition, they must also grapple with significant non-climate related challenges, which can also drive long-term value. These include social issues such as supply chain human rights, health and safety, and effective governance. Below we have included some examples of our company engagements on these topics.

Health and safety

Good health and safety practices are important for maintaining worker productivity and efficiency, which drive improved profitability and long-term value. In 2024, we engaged with Stellantis following a fatality at one of its Italian manufacturing sites. We asked the company to confirm how it was assessing the causes of the accident and what actions were being taken to prevent it from happening again. The individual involved was a sub-contractor carrying out maintenance activities on an automated section of the production line.

While the company confirmed that it had reinforced the safety requirements for employees, it was unclear how this training was relayed to sub-contractors and what sort of supervision there was to ensure that safety training was respected. The company assured us that it would investigate these aspects to prevent this type of accident from reoccurring.

Conduct and ethics

Managing conduct and ethical concerns is important for the protection of a company's brand and reputation, which helps to maintain sales and profitability, driving long-term value. Toyota has experienced two significant controversies related to misconduct in quality inspection certifications at its subsidiaries Hino Motors and Daihatsu Motor Co since 2023. In our engagements, we emphasised the importance of transparency and a third-party review throughout the investigation process, which Toyota acknowledged and responded to positively.

We held several meetings to discuss group governance issues, such as assessing oversight of subsidiaries and lessons learned to prevent reoccurrence. We also encouraged the company to strengthen its culture of compliance, and recommended voting against the re-election of Toyota's board chair at the 2024 AGM. The chair's approval rating fell to a record low of 72%, partly due to concerns about the misconduct.

Subsequently, Toyota has made improvements such as separating the certification departments from the production departments for more objective and independent assessments, and setting up a group-wide whistleblowing channel to increase transparency and encourage a speak-up culture. Toyota has also assigned senior staff with experience in corporate culture and labour management to lead Daihatsu.

Supply chain human rights

Ensuring the respect of human rights in supply chains helps protect a company's reputation and can be vital to compliance with local sales laws. This affects a company's brand reputation and sales, driving long-term value. Following a report by Sheffield Hallam University about the risks of forced labour in the Xinjiang region of China and the automotive industry,[24] we engaged with each of the main European vehicle manufacturers. We determined that none of these had direct operations or tier one suppliers in the region, apart from Volkswagen, which had a joint venture there.

Ensuring the respect of human rights in supply chains helps protect a company's reputation.

We engaged intensively with Volkswagen to understand how it was ensuring that there was no use of forced labour in its operations, and to encourage the company to disclose the full details of its due diligence actions. Although it had found no evidence of forced labour, it acknowledged the difficulty of carrying out fully independent audits in the region. In late 2024, Volkswagen confirmed that it had exited the region and sold its interests to SAIC, its joint venture partner.

Board effectiveness

Well-functioning boards are key to implementing strategies effectively and driving long-term value. We have held meetings with the supervisory board chairs at BMW and Mercedes to assess how they are managing the risks associated with the energy transition and the increased focus on supply chain issues. We also look for improved independence and better remuneration policies, as well as boards and executive teams that reflect the composition of the company's workforce and its customer base.

We have encouraged Toyota to increase the number of board directors with industry experience and genuine independence, as we consider several outsider directors to be affiliated to the company. We have met the CEO and raised our concerns about governance. At Suzuki we continue to challenge the CEO's membership in committees to enhance governance functions, as his influence may limit the checks and balances on management.

[24] driving-force-auto-supply-chains-and-uyghur-forced-labour.pdf

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