

# Eastern Influx

## Automotive manufacturing in Central and Eastern Europe\*

Part 3: How should an automotive manufacturer or supplier that has decided to relocate to Central and Eastern Europe set about closing an existing plant in another country?



## Managing the exit

An increasing number of automotive manufacturers and suppliers are now flocking to Central and Eastern Europe, drawn by the prospect of cost-savings and new markets alike. In our previous paper we discussed the issues involved in choosing the right location, but many companies also have to cope with shutting an existing factory in one country while making the move to another. In this paper we shall consider the challenges associated with disposing of such a business while optimising the value of the assets and controlling the costs.

Plant closures are a much less popular topic of conversation than plant expansions, for obvious reasons. Yet they are arguably far harder to manage. Research conducted by PricewaterhouseCoopers shows that more than two-thirds of chief executives who have closed a business without external assistance are unhappy with the outcome. They say that the biggest problems they face are finding a buyer (62%); legal complications (48%); cultural differences (31%); regulatory issues (28%); and internal communications with employees (25%).

These hurdles are often compounded by the conflicting agendas of central and local management, employees, customers and suppliers. So it is vital to get impartial input, both to understand such obstacles and to ensure that the vested interests of the respective parties do not unnecessarily prolong or derail the divestment programme. Do-it-yourself disposals frequently take longer, cost more or go wrong more often than those that are informed by objective professional expertise.

## Working backwards

In fact, the starting point for any successful exit is also the end point. Any company planning to close a factory and set up another one in Central and Eastern Europe

should begin by defining the “end state” it wants to achieve. Does it, for example, want to dispose of the entire business and invest in totally new plant? Or does it want to retain the machinery and install it in another place, as Chinese carmaker Nanjing Automobile Corporation did when it bought MG Rover?

If the company plans to continue manufacturing the same products in a more cost-effective location, it may well make sense to transfer some or all of its equipment to the new plant. But if it aims to diversify into new products and expand its customer base, it may be wiser to start afresh. The nature of the technologies the company uses will also play a role in determining how much, if any, equipment it should keep. If it makes satellite navigation systems or control systems, say, it is more likely to use rapidly changing technologies than if it makes body parts. So it will probably want to use the move to a new factory as an opportunity for upgrading its infrastructure.

Whichever route a manufacturer takes, it is important to understand the implications. Dismantling, moving and re-setting complex machinery in another place is not as straightforward a task as it might sound. It involves precision engineering, as well as an intimate understanding of the peculiarities of individual pieces of equipment – information that often resides on the factory floor. If nobody knows how such equipment can be made to work, it is clearly useless.

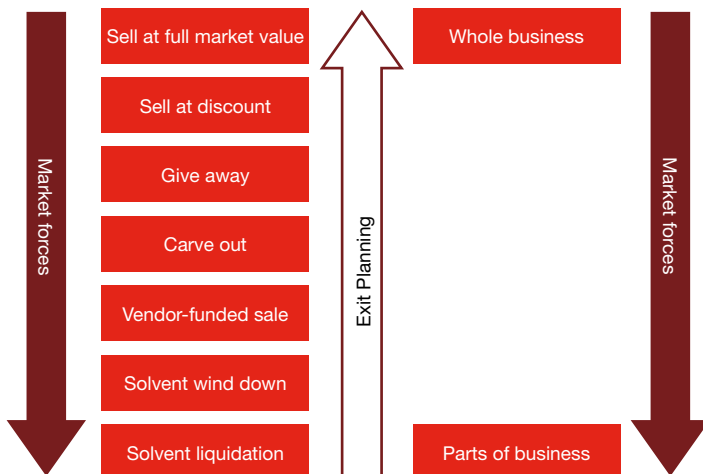
Moreover, a company that decides to re-use existing production facilities usually has to close the old plant before starting the new one. In these circumstances, it does not have the luxury of being able to exit in stages, whereas a company that is starting from scratch can manufacture new models or components at the new plant and phase out production at the old plant over a given period of time. So it is essential to identify any potential stumbling blocks and develop a clear fallback position.

## Identifying the right exit channel and strategy

It is equally important to identify the right exit channel for disposing of non-core assets. In some instances, it is possible to sell a business and its operating assets at their full market value. In others, it may be necessary to offer a substantial discount or make considerable improvements before the assets can be sold. And in yet others, a controlled wind down may be the best option (see [Figure 1](#)).

Unfortunately, some companies, especially those that are struggling, decide which exit route they want to use without considering all the ramifications. As a result, they fail to realise as much value for their shareholders as they might otherwise have done (see sidebar, [Asking the right questions](#)).

**Figure 1: It is crucial to consider all the divestment alternatives before deciding which to pursue**



Source: PricewaterhouseCoopers

## Asking the right questions

Steve Russell, Global Leader of Optimised Exit Services at PricewaterhouseCoopers, takes the view that a good exit is one which satisfies the strategic intent behind the move. This gives rise to the following questions:

- What is the end state the board desires?
- Which stakeholders can positively or negatively affect the plan?
- What is the timeline for delivery?
- What are the greatest risks associated with meeting the timeline?
- What are the greatest value drivers on the road to delivering the end state?
- What are the funding consequences of the chosen approach to reaching the end state?
- Can the board be confident that the assets or cash will not only be realised but also be released for re-use at the earliest possible time?
- What are the consequences of failure to deliver the end state?
- How can the board be comfortable that it is being kept properly informed of the current situation and any issues that are having a detrimental impact?
- Are the members of the project team able to deal with the sort of problems that inevitably arise during the course of such an exercise?

Moreover, getting the support of shareholders is critical, because one of the biggest difficulties associated with closing down an existing plant and relocating to another factory is that most of the costs occur in the early stages of the process, whereas most of the income generated from the disposal of the site can only be realised towards the end. In other words, a company frequently has to pay for the removal of equipment, redundancies, cleaning up the land and so forth before it can sell any of the assets to another firm.

Choosing the right strategy can also be very challenging, if management has never undertaken this sort of exercise before. It is often hard to identify or quantify some of the costs that may be incurred when closing down a factory. In addition to long-tail liabilities, such as environmental and product claims, there may be hidden costs like the destruction of a relationship with a customer or other stakeholder. Furthermore, time is usually a critical factor, and control of time-critical elements may not rest with the project team. An exit strategy that looks as though it might deliver the best financial returns may prove less desirable on closer scrutiny because it will take too long, and therefore tie up valuable management resources and cash.

### Creating a closure team

Once a company has clearly defined the end state it wants to attain, and the exit channel it proposes to use, it should appoint a project team specifically to manage the closure. However, many boards select project teams that are poorly qualified or not very highly motivated, both because they do not undertake exit programmes on a regular basis and because they do not see them as a glamorous part of the relocation process.

Even companies that shut sites down on a regular basis rarely have in-house teams that are experienced in managing the process, since they tend to dismantle those teams when they have done their job. In a global

survey of more than 135 senior executives conducted by PricewaterhouseCoopers, only 3% said that they had a dedicated team of divestment experts, and only 19% had even one executive experienced in managing divestments or turnarounds.

Most companies choose the members of the project team from management at the factory that is to be closed, since local staff will obviously know the business well. They will also have a much better understanding of the political environment, domestic employment laws and expectations of the workforce than anyone in head office. Such factors can vary enormously from one country to another and one plant to another – and any company that ignores them risks destroying a significant amount of value. But local managers may find it difficult to deal with local politicians, who will often fight hard to keep an operation going, even when it is clearly uneconomic. And they are more likely to lose sight of the big picture. So head-office supervision is essential.

When the project team has been appointed, it should start mapping out a comprehensive plan for managing the exit, including what must be done, when it must be done, who will be responsible for doing it and what budget will be allocated to each activity. It should also establish a regular timetable for reporting back to the board. “In many cases, the quality of the reporting deteriorates as the project advances”, says Steve Russell. “This is the reverse of what should be the case, because the more difficult issues tend to emerge in the later stages of any exit programme,” he warns.

### Securing the supply chain

One of the first tasks for any project team involved in managing the move to another plant is ensuring the continuity of the supply chain. It is essential to make enough stock to meet the needs of every customer and keep their track rolling. So, for example, if a company

estimates that it will take six months to get a new factory into production and operating at the right speed and standard, it should stockpile and store at least seven or eight months' worth of stock to cover the transition period with a margin of safety.

It is also important to take any potential changes in behaviour into account. Companies often assume that their suppliers, customers and employees will continue to work as they have always done during the winding-down period. Experience of how all these groups behave is therefore critical in planning stock builds or, for that matter, rundowns. It only takes one element of the supply chain to destroy the best laid plans and cause all sorts of problems (see box, **Stock situation**).

Any company planning to switch production from one plant to another should also provide all its customers with detailed plans of how it proposes to manage the move, and get their agreement to those plans. A carmaker whose production line grinds to

a halt because it has not got sufficient supplies of a component it needs is unlikely to be very forgiving. And competitors may see the upheaval associated with relocating to a new factory as an ideal opportunity to pitch for the business themselves.

It is equally important to ensure that the company will still be able to get the supplies it needs after the move, and that, if it is changing suppliers, it is not locked into any punitive arrangements. Manufacturers sometimes sign take-or-pay contracts, for example, under which they enjoy preferential prices in return for promising to buy a specified amount of raw materials or sub-components. When they want to terminate these contracts, it can come as a nasty shock to discover that they must pay for the remaining goods, even though they no longer want them. (The same is often true of property leases and long-term government grants. It is all too easy to forget that a lease may include onerous penalties for premature termination or that a government grant may be contingent on remaining in a given location for five or more years.)

## Stock situation

It can sometimes be very difficult to predict demand, says Nicolas Desombre, an automotive supply chain manager in the PricewaterhouseCoopers Performance Improvement Consulting practice. He cites the instance of one components manufacturer which estimated how much stock it would need to cover the move to a new factory in Eastern Europe, only to run out two months later when sales unexpectedly increased. As a result, the company suddenly had to step up production at its other factories, and manage the logistical challenges involved in shipping components much longer distances. "It's important to anticipate such forecasting inaccuracies and have a plan for managing supply continuity – for example, by increasing prices to reduce demand, reactivating production in the old factory or choosing which customers to favour first," he concludes.

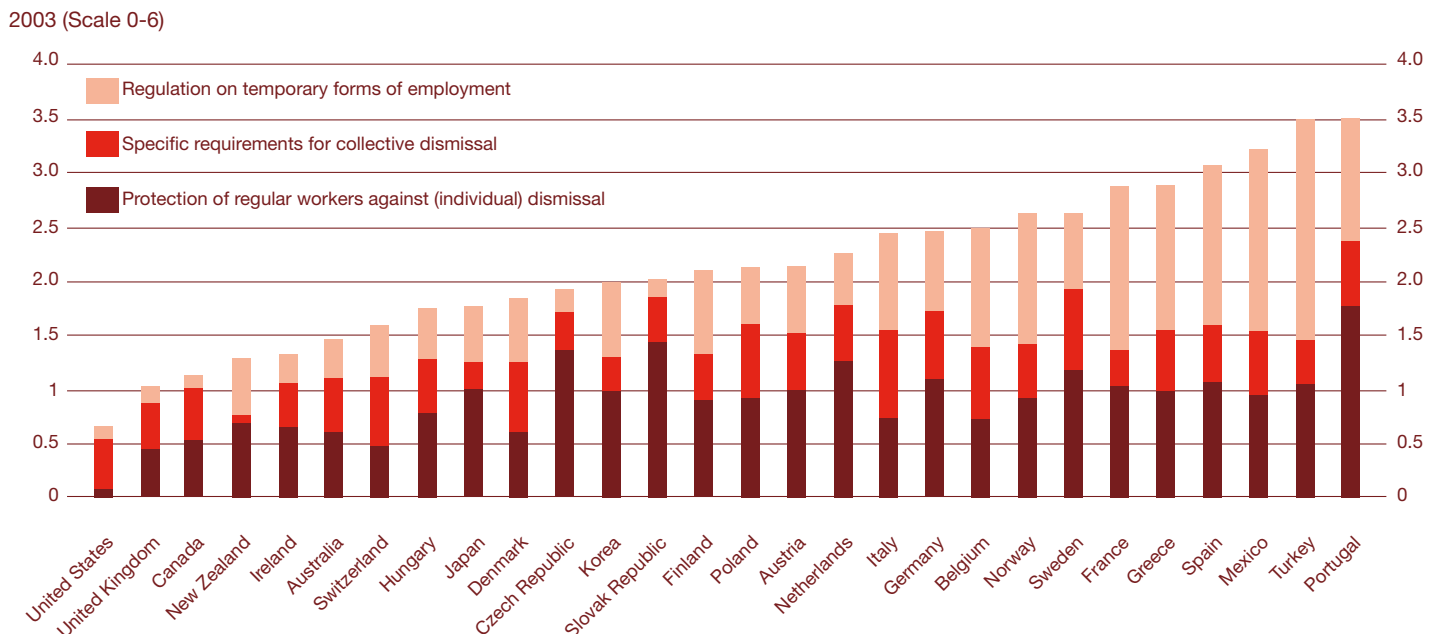
## Managing the workforce

It is also crucial to ensure the continuity of key elements of the workforce during the transition – and human beings are the most critical and unpredictable part of the equation. Most countries use a mixture of legislation, collective bargaining agreements, contractual provisions and judicial practices to govern hiring and firing decisions. But, as the OECD index of employment protection legislation shows, there are some material national differences. It is very much easier to implement a redundancy programme in the US or UK, for example, than it is in Germany, France or Spain (see Figure 2).

It is clearly imperative to adhere to these national regulations. However, it is also important to maintain the goodwill of the workforce, to ensure that it continues to be productive during the transition. This is partly a question of managing expectations; if the company has recently won a major contract, for example, and allowed staff think they will get the work, they may well feel let down when they learn that the factory is about to be closed.

But the age and aspirations of the workforce are crucial considerations, too. If most of the employees are mature, they may be happy to receive a lump sum and take early retirement. Conversely, if most

**Figure 2: The strictness of the regulations governing employment protection in OECD countries**

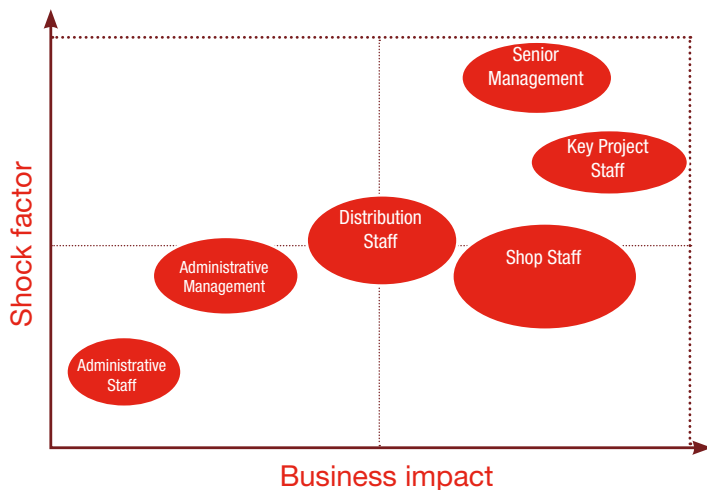


Source: OECD Employment Outlook 2004

of them are young, they should find it relatively easy to get other jobs. Any incentive programme should therefore balance the impact of closing the plant on the earnings of individual employees against the value they can create or destroy during the closing-down period (see **Figure 3**). It should also be simple, transparent, affordable and fair. With most such schemes, knowing what has worked elsewhere is invaluable (see sidebar, **Getting the incentive programme right**).

Lastly, it is necessary to identify any employees who play a critical role in keeping the plant going, provide

**Figure 3: An incentive programme should balance the shock of closure against the potential impact on the business**



- The shock factor reflects the scale of the loss of future earnings
- The business impact reflects the extent to which employees can positively or negatively affect the financial outcome of the project

Source: PricewaterhouseCoopers

## Getting the incentive programme right

There are a number of ways in which to provide incentives for selected staff to stay on and continue to work productively. They include:

- *A loyalty bonus*: a single payment (typically equivalent to one or two months' salary), payable at the conclusion of the notice period or on completion of the sale
- *A cash bonus*: a one-off cash payment for support staff who have only worked for the company a relatively short time, payable at the conclusion of the notice period or on completion of the sale; and
- *An enhanced redundancy package*: a "top-up" payment for senior management, as a "soft" reward for loyalty, leadership and high performance during the closing-down period.

Most such incentives are subject to a number of preconditions that might include: a good attendance record, the return of equipment and tools, satisfactory performance and adherence to normal professional standards of behaviour and confidentiality.

adequate incentives to keep them for as long as the company needs them and develop detailed contingency plans to cover the departure of those who decide to leave while their services are still required. Some of these key personnel will be easy to determine, but others may not be so obvious; the supervisor who knows everything that is happening on the factory floor may, for example, make as useful a contribution as senior management in his own sphere.

### Conducting a first-rate communications programme

A strong communications programme is also vital. Many stakeholders – including staff, local authorities, trade unions and other factories within the company – are affected, when a plant is to be closed. It is important to communicate clearly and regularly with all of them.

Moreover, redundancies generate a lot of emotion. Even those whose jobs are not immediately at risk are likely to be upset by the loss of their colleagues and by the corresponding increase in their own workloads. Clear written and oral communications can help to eliminate any misunderstandings and set a positive tone. They can also increase the morale and motivation of employees the company wants to retain, and reduce the stress of those who are to be made redundant.

Before going public, the company must obviously comply with the statutory requirements; draw up a plan for communicating with all the different stakeholders, including unions, staff associations, shareholders and the media; and put measures in place for dealing with rumours and leaks. During the closure process itself, it should consult union representatives, issue individual notifications of redundancy and provide a programme of employee counselling for those who need such support. Thereafter, the company must manage the organisational changes arising from the redundancy

programme – and it is often a good idea to let employees at any other factories within the organisation know what has been done to help those who have left. It is also essential to keep customers and suppliers abreast of the situation, preferably by telling key contacts what is happening face to face.

### Capturing and transferring knowledge

It is equally important to capture the knowledge within the existing site and transfer it to the new factory. This is partly a process of asking the right questions of the right people, and then defining and recording good working practices, many of which have probably been carried out for years without any formal articulation. One of the advantages of crystallising such “tacit” knowledge is the scope for simplification and standardisation of processes that may have become unduly rigid or complex, simply because that is how “they have always been done”.

However, hands-on training is necessary, too. Some manufacturers bring supervisors from the new site over to “job-shadow” those at the old site, but many companies find that they also have to send some of their most experienced staff to the new plant on a temporary basis. Furthermore, training new employees often takes longer, and has a bigger impact on productivity, than expected. When skilled personnel have to spend time training others, for example, their own productivity declines.

### Addressing environmental issues

Any automotive manufacturer that is not selling its factory as an ongoing business concern will simultaneously have to deal with the numerous environmental issues involved in dismantling the existing infrastructure and decontaminating the soil and groundwater. This is particularly burdensome when a

site is more than 25-30 years old, since construction standards were lower then and many industrial processes and practices were more likely to cause pollution than they are today.

The insulation, roofing and walls of many buildings erected before 1980 include asbestos, for example. Buildings erected after that time are generally safer, though the roof or floors may still contain asbestos construction materials. Strict regulations apply to the demolition of any edifice containing asbestos construction materials, as well as the disposal of such materials.

Decontamination is also a major concern, especially when the company wants to sell a redundant site for non-industrial use. The rules vary from one country to another, although the European Commission is in the process of harmonising those that apply within the 27 member states of the European Union, under Directive 2004/35/EC on Environmental Liability. In

most states, the site operator is legally responsible for any contamination on the site, and remains responsible even when it has sold the site to a third party. It can enter into an agreement with the purchaser to discount the sale price and transfer the financial risk, but it cannot transfer its legal obligations and will have to recover its costs privately.

Environmental liabilities can arise from a wide range of contaminants governed by different standards. They may also involve other potentially responsible parties, such as previous operators, and there are many different technical solutions for cleaning up the contamination. If the contamination causes no imminent threat to the environment or human health, the operator is usually required just to monitor the situation. It is only when a company is closing a site or transferring it to another owner that other environmental obligations will arise. So it is often extremely difficult to estimate the current and future costs of such liabilities in advance, (see box, [Counting the cost of cleaning up](#)).

## Counting the cost of cleaning up

Decontamination costs can be very significant, says Eric Davy, head of environmental due diligence activities at PricewaterhouseCoopers. When one French automotive parts manufacturer involved in the production of galvanized steel plates for vehicle body parts recently tried to sell a site, for example, the environmental due diligence process showed that there was zinc in the groundwater. The manufacturer had to undertake a five-year “pump-and-treat” decontamination programme costing 3m euros.

## Planning for contingencies

Lastly, it is important to plan for, and deal promptly with, any contingencies that arise. No company can anticipate all the problems it is likely to face when it shuts an existing factory in readiness for the move elsewhere – although many unexpected problems are only unexpected to the inexperienced or unwary. However, it is generally the unexpected problems that cause the biggest delays and destroy most value. Some of these problems may be relatively easy to resolve. Others, such as the termination of joint ventures and division of the assets, may be much more time-consuming.

## Conclusion

In short, managing an exit programme is rather like running a military campaign. It requires the same sort of discipline, organisation, continuity and precision. But it is also crucial to set a deadline and, once that deadline has passed, draw a line under any problems that remain. The key goal of any automotive manufacturer relocating to Central and Eastern Europe is to enhance the value it creates; and that means management must be able to focus on going forward, rather than driving with one eye constantly fixed on the rear-view mirror.

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