

Sustainable cost reduction in the automotive sector



After a successful establishment and aggressive growth, the domestic automotive industry has been recently hit by the financial crisis. Falling demand resulting in weak revenue puts immediate pressure on the company's bottom line. The only answer to this change is to quickly adjust the cost base. This article should provide some practical hints about successful approaches to sustainable cost reduction.

The automotive industry has been deeply affected by the global financial crisis. Some of the problems it faces – lack of credit, declining consumer confidence and falling demand for new vehicles – are familiar. But, together with new pressures such as increasing raw materials costs, rising fuel prices, tighter regulations and the need to satisfy consumer demand for cleaner, greener cars, they have combined to create a 'perfect storm' such as the industry has never previously experienced. The key challenge is how to balance the pressing demands of the 'here and now' with the need to create a business that can thrive in future years. As per the 12th Annual Global CEO Survey, conducted by PricewaterhouseCoopers in the last quarter of 2008, the vast majority of automotive CEOs (92%) recognize that innovation is one critical ingredient for long-term survival.

The changes in the economic environment drive the need for innovations even in cost management practices. During the period of accelerating economic growth, most of the car manufactures pursued market share strategies. Nowadays, they are shifting the focus upon operational excellence. These days, most automotive CEOs are cutting costs and re-evaluating their business models, as they struggle to balance the immediate demands of survival with the need to develop

an approach that is both durable in the longer term, and that will position them to take advantage of the economic recovery, when it occurs.

As highlighted on the graph below, the nature of the action required depends on the magnitude of the cost challenge. Our benchmarks show that immediate cost savings of up to 10% of the cost base can be achieved by tightening budget control and focusing on quick-win initiatives. If a company aims at making reductions in the range of 10 – 20%, then changes in the business processes are essential. Should the aspiration exceed 20%, then we are talking about restructuring initiatives requiring fundamental changes in the company's operating model, or the system's infrastructure.

From the value cycle perspective, the significant cost reduction opportunities lie in supply chain optimization, improving the product development cycle, better linking of sales forecasting to production planning, simplifying and streamlining the production processes, or enhancing the efficiency of the distribution network. We are seeing OEMs and Tier1 suppliers getting more financial flexibility by renegotiating with suppliers, replacing low value add suppliers with cheap alternatives, freezing investments and R&D costs, reducing production capacity by

reducing the number of working shifts or providing incentives to dealers to generate near-term cash.

Most cost reduction programs fail at the execution stage. The traditional 'cost cutting' approaches tend to either gravitate towards repeated insufficient attempts to equally cut costs across the board, or pursue bold initiatives, but fail to stabilize the cost culture of the business. The largest challenge by far is to make the change stick. Generally, successful companies are often resistant to change because they have a track record in doing things successfully the way they have been used to, not realizing that the context has changed. The wisest approach is not to simply give orders, but to sell ideas internally across all levels of management. That way the people at all levels can contribute with ideas and

understand the need for such an action. It also helps to achieve the required focus of the initiative and avoid pitfalls of an arbitrary cost cutting approach.

Our experience shows that successful programs share similar characteristics:

1. Strong Executive Mandate is required to encourage organizational openness
2. A dedicated team is required to shape the program and to manage its execution
3. Scope and targets must be realistic and consider organizational maturity
4. Stakeholders must be committed and engaged throughout the process
5. Accountability for benefit realization needs to be shared with the business owner
6. Risks will need to be mitigated

The cost reduction programs should not be seen only as a survival tool. When designed and implemented properly, these initiatives have a positive impact on companies, enabling them to create durable organizations that can weather the current storm and succeed in the longer term.



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