Managing the automotive downturn effectively

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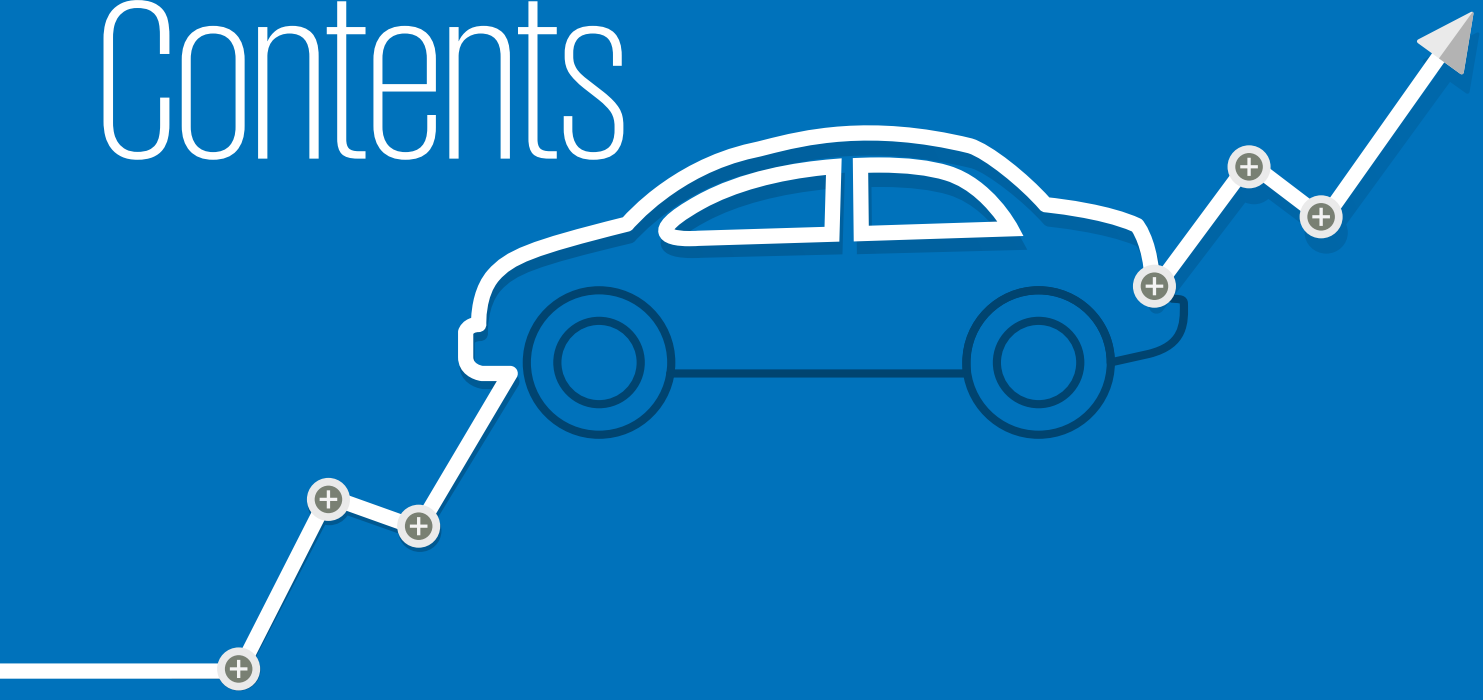


Context

The Indian automotive industry is in the midst of a deep slowdown. The passenger vehicles (PV) sector is most affected after witnessing consistent growth over the last 8–10 years

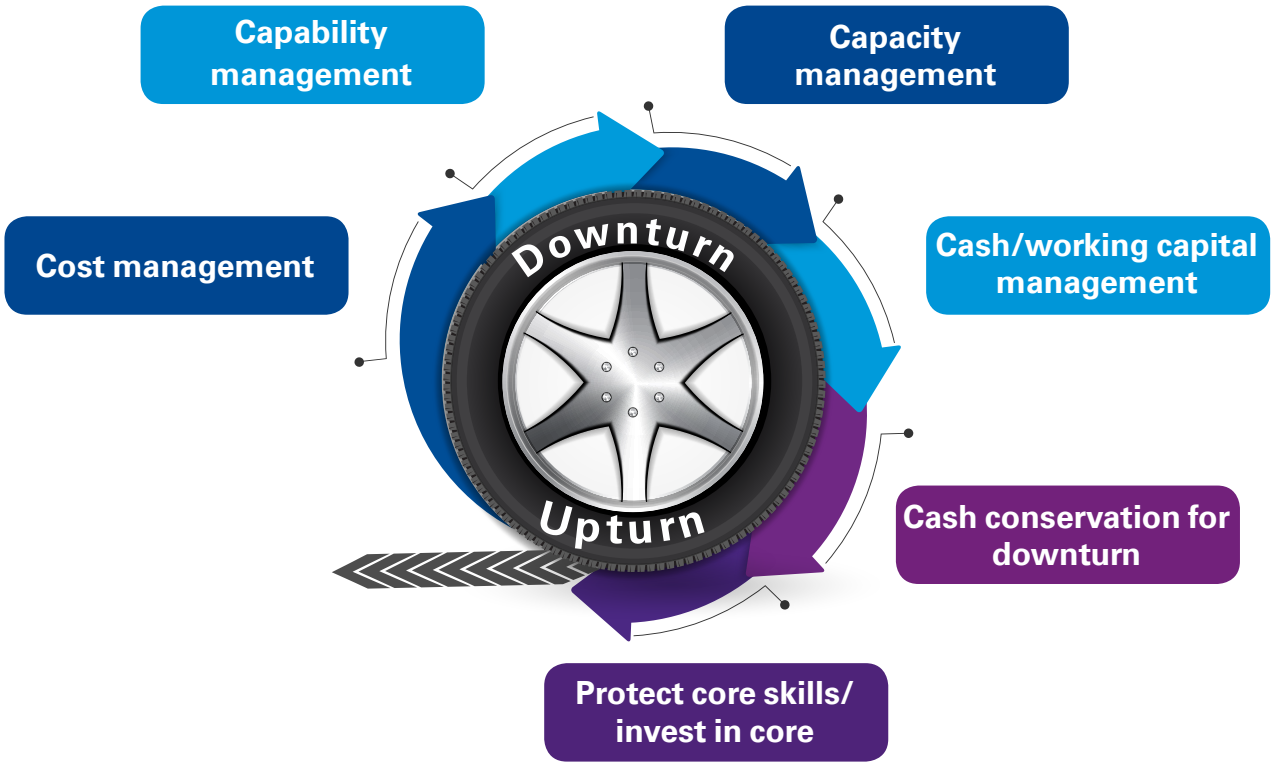
The passenger vehicle (PV) segment witnessed a CAGR of 6.7 per cent between 2010 and 2018 compared with the global growth rate of 3.2 per cent. There was obviously a positive rub-off on the domestic component industry - the automotive component industry expanded at a CAGR of 10 per cent between 2012 and 2018[1].

This growth led to the development of a scalable auto-component industry, generating significant wealth, enhanced export competitiveness and cash surplus to invest in R&D and business diversification.

This rapid growth, however, also ensured that the focus on achieving the optimal operating model, 'right-sized' organisation and the most efficient cost structure was not always the topmost priority. In short, the industry was not preparing itself for a slowdown as no one was able to predict the same.

In the first nine months of 2019, PV sales in India declined by an unprecedented 25 per cent. Thereby impacting the cash position of component suppliers and putting their business sustainability at risk. Managing the downturn and ensuring the survival of business sustenance is the immediate priority for these players.

How to effectively manage the downturn



1. Turnover – Auto Component Industry: 2017-18, ACMA, December, 2018

Cost management can yield significant benefits in a downturn

Auto manufacturers can derive cost benefits by focussing on reducing direct material costs and optimising indirect spend.

Design-led cost management

Design-led cost management can alone yield a financial benefit of approximately 8 to 10 per cent through yield improvement and specification optimisation driven by internal and external benchmarks.

Strategic sourcing

Strategic sourcing can reduce costs by 5 to 7 per cent for a company. The levers to be used are analytics driven negotiations (use of statistical tools such as Linear parts pricing and value chain and cost driver led zero based costing), development of alternative sources and volume consolidation.

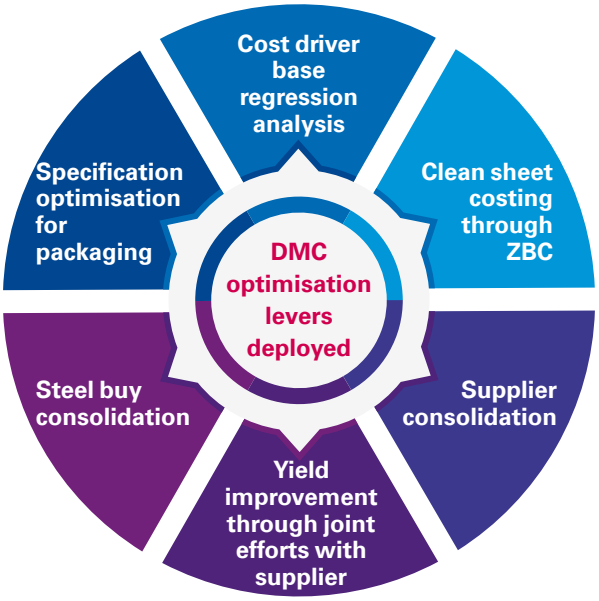
Case study: Direct material cost optimisation

Mid-sized auto component player – savings of 7 per cent on addressable cost base

Client situation

- Mid-sized, tier 1 components supplier
- Facing 20 to 25 per cent volume reduction due to prevailing slowdown

Key elements of proposed programme



Outcome

- Savings of 7 per cent on addressable cost base
- Successful improvements with tier 2 suppliers leading to higher yield and process efficiency

Significant savings through indirect spend management

Indirect spending management can help companies save 10 to 20 per cent of their operating costs. Companies can adopt various strategies such as zero-based budgeting, reduce the demand for overhead expenses by conducting internal analysis, automate work or digitally equip an organisation to increase efficiency and reduce costs and maximise the utilisation of current resources based on payments.

Case study: Indirect spend optimisation – logistics

Leading auto component firm with revenue of INR2,700 Cr, reduced logistics cost by 5 per cent within six months

Area	Key levers	Savings identified	Savings implemented within six months
Outbound logistics	Alternate transporter market rate benchmarking	8%	6%
	Price discovery and transparency		
	Benchmarking and SoB of existing transporters		
	Consolidating transporters		
	Route and fleet mix optimisation		
	Leakages in challan charges		
	Leakages in contract		
Inbound logistics	Alternate transporter market rate benchmarking	7%	4%
	Price discovery and transparency		
	Bundling inbound and outbound contracting		
	Fleet mix optimisation		
	Backhauling		
Overall savings		7.2%	5%

Capability management principles to sustain lean operating models with efficient organisations

Levers for capability management

KPMG in India has six levers for a target operating model, organisation design and workforce optimisation.

3 Workforce productivity analysis

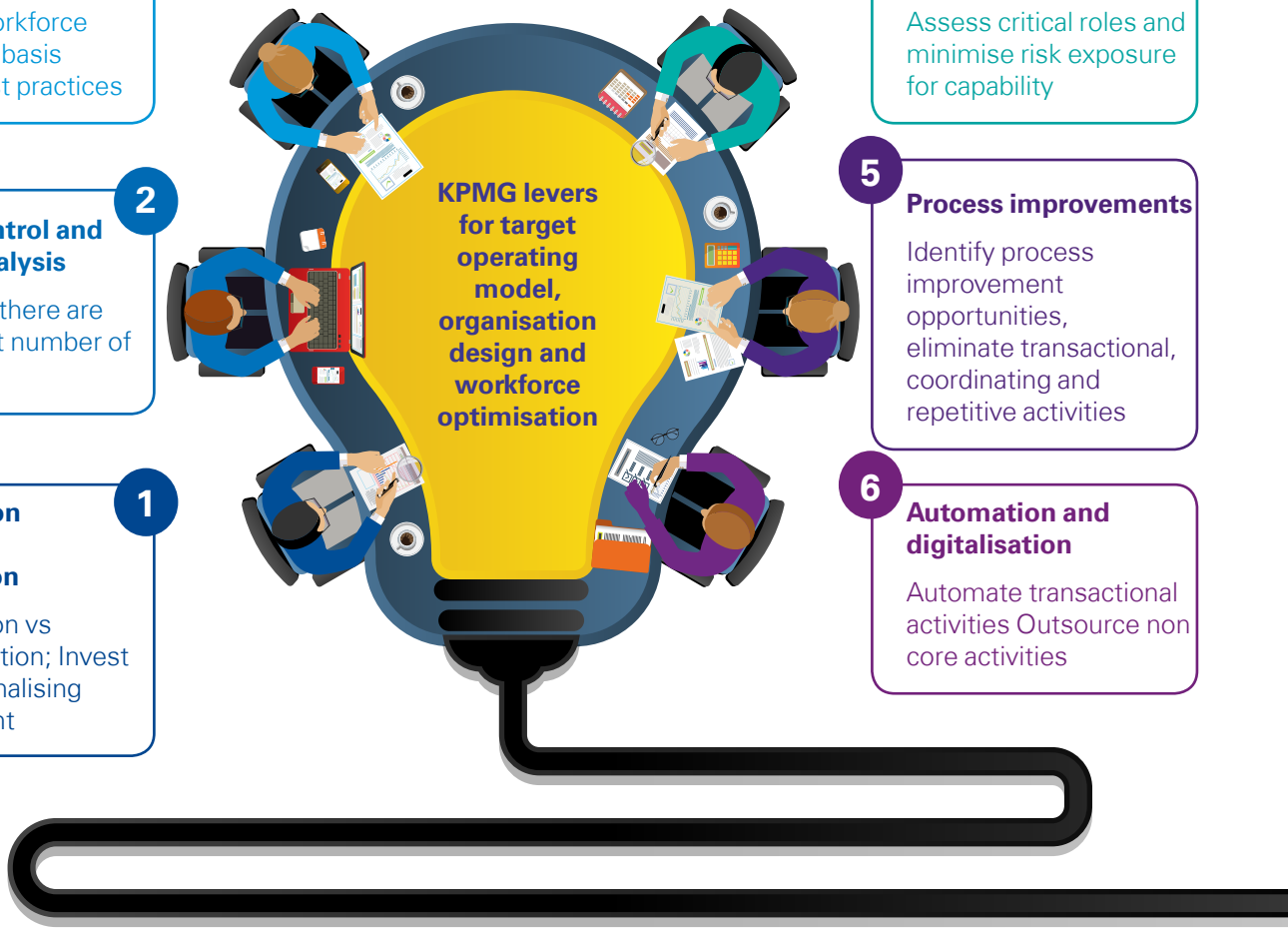
Measure workforce productivity basis industry best practices

2 Span of control and layering analysis

Ensure that there are just the right number of layers

1 Organisation structure optimisation

Centralisation vs decentralisation; Invest in professionalising management



4 Critical roles segmentation

Assess critical roles and minimise risk exposure for capability

5 Process improvements

Identify process improvement opportunities, eliminate transactional, coordinating and repetitive activities

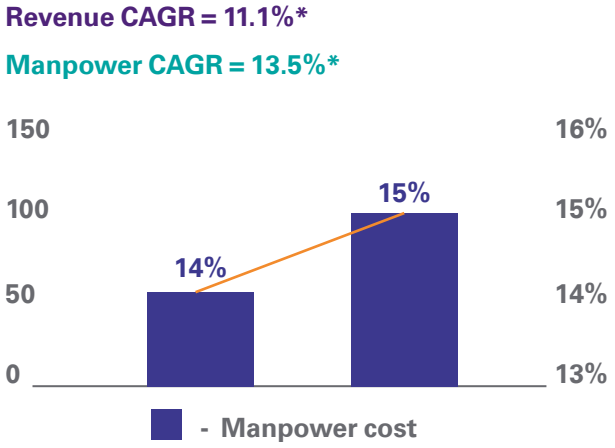
6 Automation and digitalisation

Automate transactional activities Outsource non core activities

Case study – Organisation structure optimisation

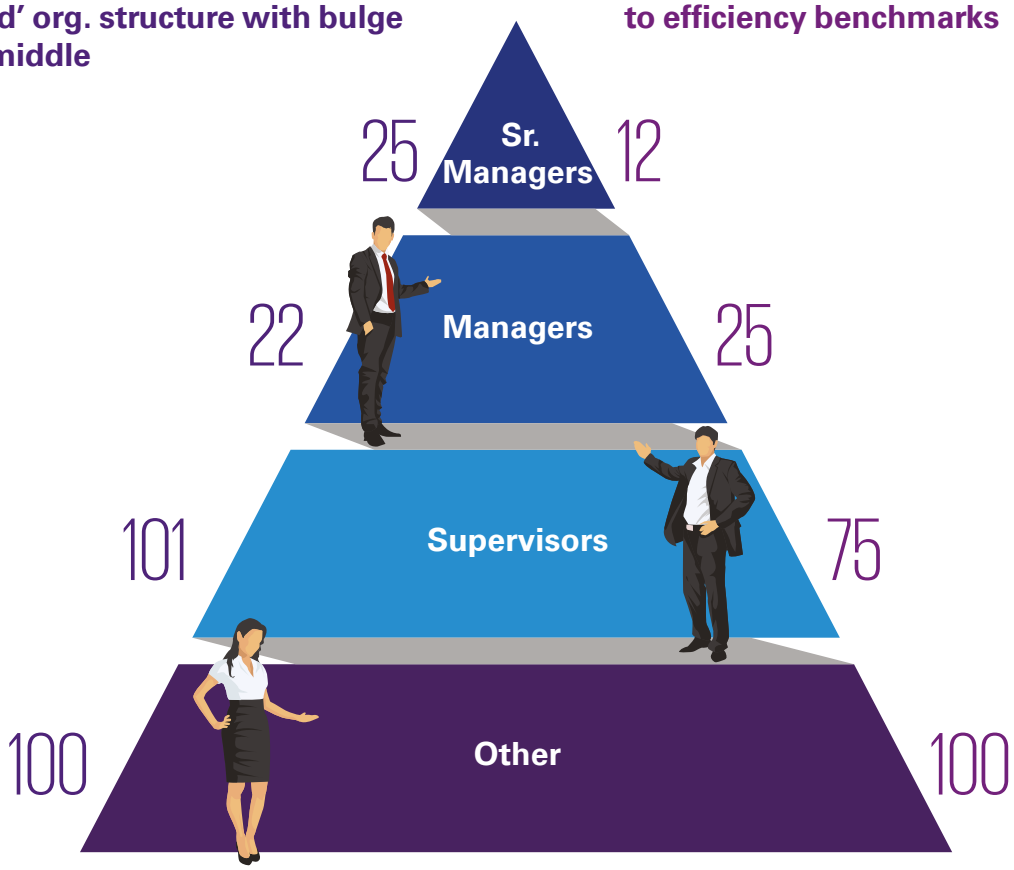
Auto component manufacturer – legacy organisation structure transformation

Manpower cost increased significantly



As-is assessment – legacy, 'lopsided' org. structure with bulge in the middle

To-be org. structure more aligned to efficiency benchmarks

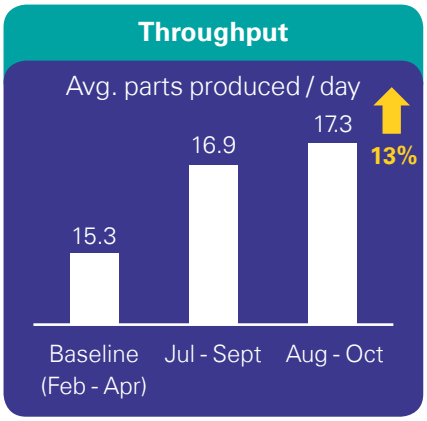


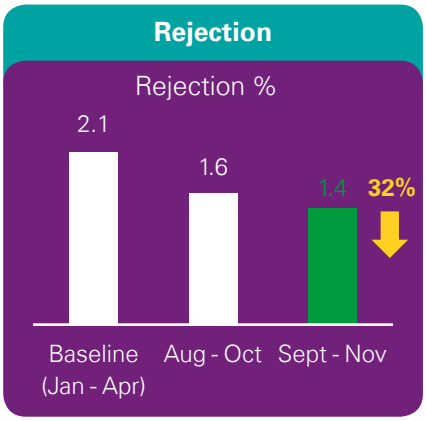
Even in a downturn, capacity management remains a key lever - all operating facilities should be at maximum efficiency

Operate assets at maximum efficiency – "shut down" everything else – reduce fixed cost curve

Case study 1 – Throughput improvement

Enhance operating asset effectiveness





Key levers deployed

- Predictive maintenance to reduce breakdowns
- Process time variation standardisation
- Enhanced material and production planning

Case study 2 – Operational excellence

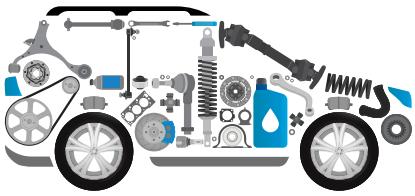
Maximisation of margin per shift by operating assets at maximum efficiency and shutting down spare capacity

Key inputs optimised per machine → **Number of shifts operation** → **Parts to be produced** → **Manpower deployment**

Inputs

- Customer schedule
- Part wise production and dispatch on previous day
- Machine wise part level data (cycle time, available logistics, manning norms, etc.)

Dynamic shift optimisation



Outputs

- Run plant at optimal point
- Optimised shifts/ machine operations, manpower deployment per day

Machine	As-is shifts	To-be shifts
Press 1	60	50
Press 2	60	51
Press 3	60	65
Total	**180**	**166**

Cash/working capital management

Strong control on cash and daily simulation of cash is critical to run the operations during a downturn.

The framework to achieve tight control on cash covers three areas:

Review all spend

- Unless it is critical for operations, defer it!
- Continue investing in R&D – its highest ROI
- Comprehensive risk management framework

Comprehensive review of AR and AP

- Comprehensive review of accounts receivable and accounts payable
- Cash position simulation
- Centralised management and control
- Rigour in review of
- daily cash flow

Comprehensive tracking

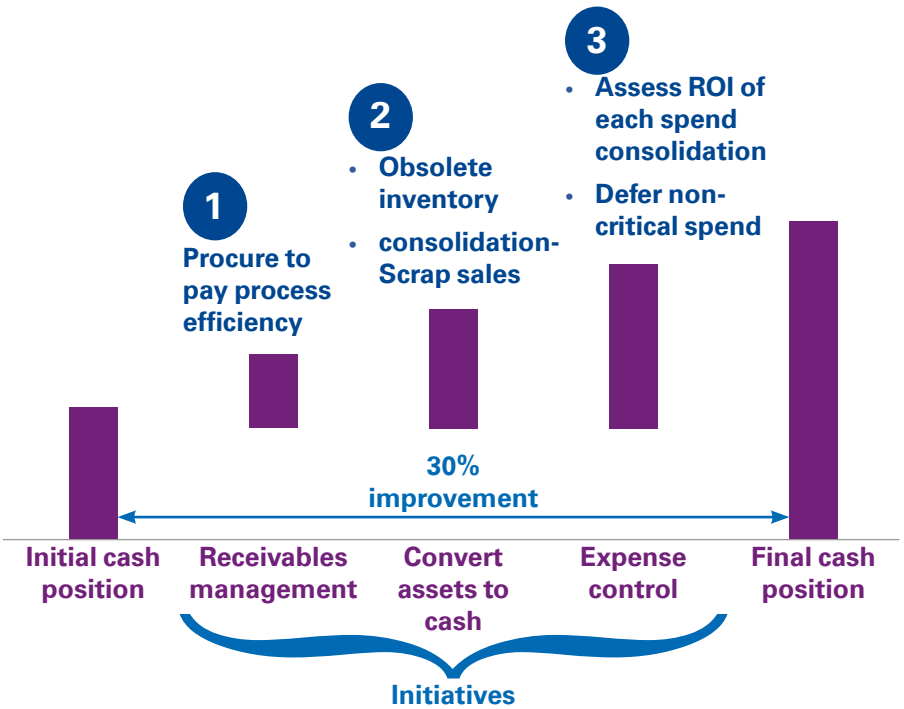
- Comprehensive tracking of advances and on-account transactions – both customers and vendors
- Timely payments to suppliers

Case study: Cash/working capital management

For a leading manufacturer of industrial pumps, with a turnover of INR550 Cr, working capital management led to additional liquidity

Context

- Tight cash/liquidity position
- Review gaps in working capital and cash flow management
- Initiatives to infuse cash and enhance liquidity



The way forward

Key takeaways for automotive manufacturers to manage the downturn.

What to continue?

- All resources in a company, be it people or machines, should be operating at their peak, maximising capacity and throughput
- Companies should invest in skilled talent, especially in employees skilled in running the core business
- Businesses should continue to follow 'lean principles' and focus on managing costs, maximising working capital efficiency and reducing inventory
- Auto manufacturers should continue investing in developing tier two or tier three suppliers. This will help them strengthen their supply-chain networks and work with suppliers that are not affected directly by the downturn
- Auto manufacturers should not delay payments to tier two or tier three suppliers, citing reasons such as a cash crunch. On the contrary, they should support their suppliers by making timely payments.

Things to avoid

- When making an expenditure decision, auto manufacturers should determine if it is vital to the core business
- Auto manufacturers should not run machines at a sub-optimal rate simply because of low volumes. Only high operating assets should be installed in factories
- Usually companies lay off talent to decrease expenses and save cash but in a downturn, they should not make the error of laying off critical and skilled labour
- To cover day-to-day expenses, businesses should not cut their R&D expenses. R&D investments are long-term investments and should not curtailed for short-term savings.
- Clear transactions and interactions with OEMs and vendors are essential. Mistrust can cause delays and cost the business more.

Things to start doing

- Businesses should start analysing every cost item. Auto manufacturers will have to begin this process from the start and use a clean sheet strategy to determine essential expenses and areas that need improvement
- Auto manufacturers need to become more innovative and begin exploring partnership opportunities for better capacity utilisation. These partnerships can also be with competitors
- Businesses should invest in talent as reskilling and upskilling workers will improve operational efficiency and cost effectiveness. Automakers should also focus on making talent 'fungible', which implies that businesses should be able to evaluate workers' output in a standard way for better evaluation
- Auto manufacturers should think of transforming businesses to be more tech enabled and automated. This can be a parameter that will help them survive competition and downturns. This transformation should be undertaken in a top-down manner, and should challenge the existing designs and operating systems.

Treat downturns as opportunities to catalyse the 'big bang transformation'

Do it once Do it right

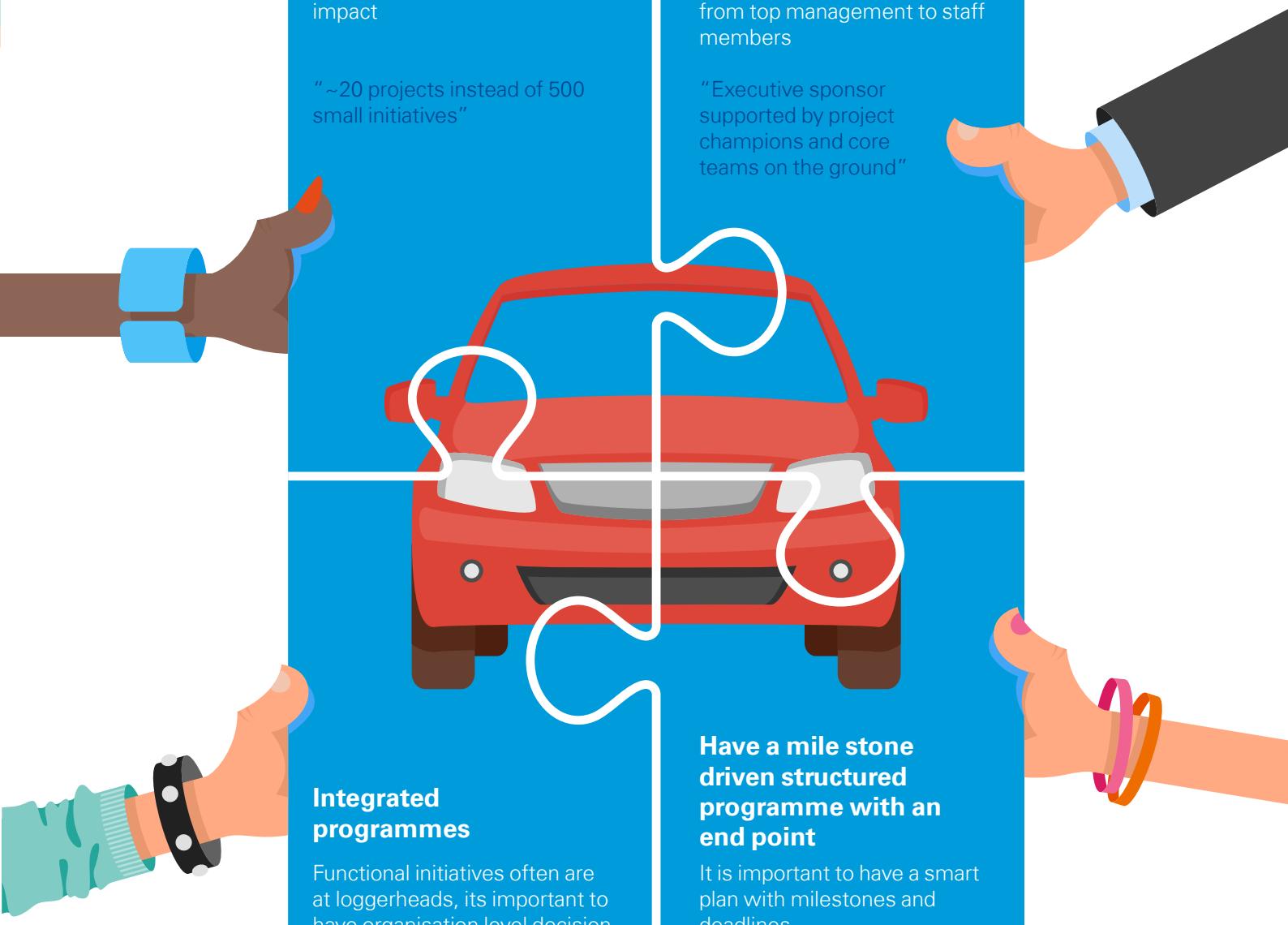
Smaller standalone initiatives running in silos make limited impact

"~20 projects instead of 500 small initiatives"

Aligned organisations

A transformational journey requires commitment right from top management to staff members

"Executive sponsor supported by project champions and core teams on the ground"



Integrated programmes

Functional initiatives often are at loggerheads, its important to have organisation level decision making

"Interlinked impact of all projects with company-level optimisation instead of individual teams chasing local optima"

Have a mile stone driven structured programme with an end point

It is important to have a smart plan with milestones and deadlines

"12 months plan with milestones for baselining, initiative planning, quick wins, long-term initiatives and sustenance"

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