COFFEE Break

Stuck in the jungle of Cost Reduction.

A supplier in the Brazilian automotive industry - with João and Fernanda at the table - limit of cost cutting.

Writer
Project Team of iManagementBrazil Ltda., São Paulo, Brazil

Photos & Illustrations
iManagementBrazil Ltda.
iStudioBrazil, Brazil

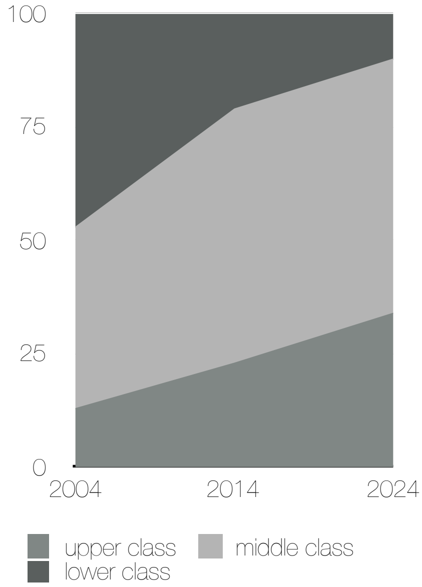
April 2018

Preface

Where are the limits of cost cutting? Many companies are forced by the circumstances to face this question. It is often those companies that have to stand idly by and watch their sales slump, new suppliers change the market structure or where markets are undergoing transformation as a result of overriding and regulatory intervention. The cut into the muscle quickly improves the result. However, the moment comes quickly when more than just the courageous cut is needed - an exit to regain the lost market, an attack on the new competitors is needed.

Almost two years ago, iManagementBrazil Ltda., São Paulo, took over a project at a large international automotive supplier (CEO, plant manager) which had slipped into a deep and very threatening situation due to various internal decisions in the near past and the delayed reaction to the changed environment of the local market. The local management of the company at the São Paulo site no longer existed, the company had massive quality problems and was no longer able to meet delivery deadlines. In the first half of the financial year, the automotive supplier had reported a high double-digit monthly negative result instead of profits. The delivered product quality was between 75-100% daily refusal rate by the automobile companies. The market launch of nine components for a new model of the main customer VW do Brasil was extremely late and increased the risk for the automobile brand of having to postpone the market launch.

Market situation and history of the local market. Brazil is one of the world's largest global automotive markets. The country is currently in fifth place in the global car sales comparison. A decade ago, the local automotive sales market was in eighth place. In a comparison of global car production, Brazil occupies seventh place, with only 15% of the vehicles produced being exported. The local domestic market absorbs the remainder of production, which puts Brazil in 21st place among car exporters. The massive change is accompanied by the country's changed social structure. Whereas at the end of the last millennium, more than half of the Brazilians were in honor of the poor, today more than half of the total population are in the middle class, about 1/4 of them belong to the upper class. This makes Brazil the first emerging country to have developed a sustainable middle class and the income distribution has had a positive impact on the total population.



These conditions attracted and continue to attract new car manufacturers. Currently, 24 car brands in Brazil produce about 3.0 million vehicles per year (2016) with approximately 360,000 direct employees and about 1.5 million indirect jobs. The installed new-build capacity is around 3.8 million new vehicles per year. The Brazilian automotive industry represents 5% of GDP and 21% of industrial GDP. To understand the structural changes in the automotive market and their impact on our client, another look at the historical development of the Brazilian automotive market is important. The market leaders are Fiat, General Motors and Volkswagen, where VW has served 60% of the local Brazilian market in the past. The current boom in the Brazilian automotive industry was registered between 2003 and 2013; annual double-digit growth rates were recorded.

Volkswagen, Toyota, Chevrolet, Ford, Fiat

Honda, Mitsubishi, Renault, PSA, Nissan, Mahindra

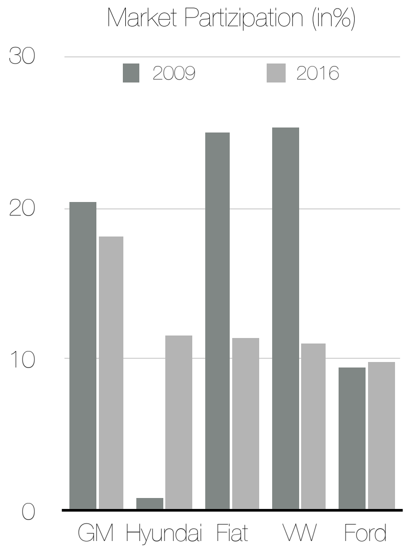
Hyundai, Suzuki, Chery, JAC, Audi, BMW, Mercedes Benz

The main customers of our client were the three market leaders, with VW accounting for more than half of the total turnover. In addition, there were product lines for some newcomers which, however, did not represent a significant proportion. In particular, the former market leader VW suffered during the period of massive expansion of the Brazilian market loosing massive local market share.

One of the main reasons for this is the fact that in the whole expansive decade of Brazil, no newer model was actually introduced to the market and in the recent past, the VW UP! model tried to stop the trend, which, however, did not take into account the reality of the changed Brazilian social structure and the sales figures are noticeably behind the plan to this day. In the period between 2009 and 2013, the core period of the automotive boom, VW do Brasil sales fell by a further 15%.

The pressure is growing.
During the period of the most intensive expansion of the Brazilian automotive market between 2009 and 2013, our customer's main customers group lost approximately 11% of the market share. In the same period, marked by the aftermath of the global financial crisis at the end of the last decade, the traditional market leaders, in particular VW do Brasil, reduced the development costs for new product launches. In the case of VW, these cost positions were virtually erased and only models that had been on the market for a decade were sold.

This trend continued in the same way for our client. In order to maximize profits during the financial crisis, the development costs for new vehicles are also completely eliminated and the development department is closed. In the same period, newcomers to the local Brazilian market developed very dynamically and brought new and better equipped vehicles onto the market.



Due to the lack of development capacity, our customer was excluded from this trend among the new competitors on the market. In the course of the 2013 financial year, this trend deepened and indicated a further reduction in the number of new vehicles produced by -20% with a view to the 2014 financial year. Our client only supplied parts for the old models in the market, which were due to leave the market within a period of two to three years. This was accompanied by the rapid decline in margins for these vehicles and the consistent transfer of economic reality to the supply chain by automobile brands.

At the end of the 2014 financial year, our client implemented a massive reduction in the workforce. The planning was carried out outside Brazil and does not take into account the effects on the 2015/2016 budget in connection with the requirements of local labour law. The conditions in Brazil are quite resolute and require a high level of protection for workers who are able to show signs of illness as a result of employment. As a result of the dismissal, productivity in the assembly lines was reduced, but the budgets for 2015-2017 were not adjusted. The proportion of workers classified as chronically ill increased disproportionately. As a result of the international matrix organization in the individual specialist areas such as production, purchasing, engineering, human resources, etc., the aim was to achieve "optimization" in the individual areas without, however, having an eye on the entire value-added chain with its effects for the entire company.

Leadership crisis becomes visible. In the first quarter of the financial year 2016, specialists from all departments and various continents were sent to Brazil for optimization without any local management being available - the plant manager and divisional manager, who had been dismissed at the same time. In addition, the relationship with local union leaders was completely poisoned and marked by mutual mistrust.

The requirements for the Interim Manager appointed at the beginning of the second quarter of 2016 as factory and divisional manager were characterized by the fact that the time until the new manager was appointed to use the time to set up and implement a Contingency Plan and to control product quality to such an extent that nothing stood in the way of VW's market launch. Instead of posting an operating profit of US$ 0.5 million per month as budgeted, the same amount was booked as a monthly deficit. The accumulated result was already -12% on the total annual result.

The complexity continued to increase due to the presence of specialists from different nationalities, which made high demands on the management of intercultural teams.

„Change Management fixes the past, transformation management creates the future.“

- AS WE UNDERSTAND A CHANGE PROCESS -

Flying start. The time for this requirement was extremely short. We applied the quick audit developed by iManagementBrazil in recent years to identify the problem clusters. This instrument ensures that the problem areas can be identified quickly and clearly, but there is still no solution. The Interim Manager will be able to act very quickly in the problem clusters and thus gain time for the development of solutions and their implementation.

At the same time, an interim manager was selected, who had already successfully performed the change management under pressure several times in different industries in Brazil. It was not the background of the automotive industry, but a high degree of resilience to bring all stakeholders to the table and to channel opinions and discussions, as well as to give the local Brazilian realities the necessary freedom.

Our project approach is always based on the assumption that we do not give the restructuring project a resounding name, but rather clearly name the topic. It must also be ensured that the complexity of the organization for the change management project is kept as simple as possible and ensures that all employees understand the process.

There was a massive risk that the same structures of a change management process would creep in immediately and be put into practice by everyone involved, as is well known. At this point, the entire experience and independence of the interim manager was in demand. What principles could the interim manager use to counter the risk of the project running empty?

1. Knowing when something needs to be simplified. No change process is linear and strategically planned. It depends on the daily and instantaneous tactics to recognize when opportunities arise. The interim manager does not have to think about career-related behaviors and was able to give the process room for maneuver.

2. Have simple and non-negotiable principles. It is possible to keep things simple, even though the environment is complex. It is enough to define the principles clearly and declare them non-negotiable. This prevents dilution and keeps the compass in hand.

3. Distribute project responsibility in small doses. Giving employees step-by-step autonomy in the change process to increase decision making and experience. To recognize the attempt of total control as a helpless attempt to give a structure to a large organization and to resolutely reject it in the change management process.

4. Spend time on what really matters. The project meetings prevent too much time being talked about the past and creating "guilt feelings".

5. Knowing when complexity is an advantage. To develop an understanding of where the nucleus of the process lies and where complexity creates an anchor for measurability.

6. Being simple does not mean to be superficial. Following a simple project management does not mean reducing ambitions or ignoring necessary complexity.

João and Fernanda. In order to give change management another visual component of the integral view, two life-size cardboard figures were created which "participated" in every project meeting - João and Fernanda.

João represented the car manufacturer and always got a cap with the producer's logo, Fernanda represented the end customer. Through their physical presence, the project team made themselves continuously aware of who and where the goal of all efforts was.

In this project environment, the Interim Manager asked the same questions and made observations of all process participants.

Do we have the right strategy and tactics? One could quickly see that the Group Management only wanted to solve the pressing

problems and wanted to achieve a maximum improvement in results by the end of the year. A strategy was not defined by this side.

Do all those involved take enough time? For too long, group management was limited to defining tactical steps and not taking the time to define a new reality of the company through hard work. At the operational management level, it was clear that they wanted to get down to day-to-day work as quickly as possible and that they had forgotten how to organize it. But the condition was accepted.

Did we start with ourselves? The Taylor´ism thinking had led to the fact that the remaining management level of our client always believed that it was necessary to persuade the employees to do things differently, that is to say, better. The Interim Manager focused on understanding what to do in the upcoming process and what to do personally. The purpose and necessity had to be so deeply internalized that no one could be diverted from the overall project by any seemingly important operational problem, and nobody would take on the duty to make changes with the team and become so authentic that the language remained comprehensible to everyone. **Do we have courage?** The interim manager repeated a question over and over again: **What are we managers paid for here?**

As managers, we have to do our very own job and take personal risks. Imagine a city on a river. Life there is wonderful, everyone has enough space to live and eat. Then it becomes too narrow and there are violent conflicts. After all, one of them has an idea. It's green and lush across the river.

But how are we supposed to get there? One of the people, presumably a manager, grabs a liana and tries to swing over. The vine is too short, so he swims back. But executives are paid precisely for it - to overcome this last piece, even without a double bottom and without a net, and to ensure that the others follow suit.

Why do so many hesitate to go the way? With our client, many employees did not know what they were getting into, whether it was the right time at all, or whether they did not know how to do it. That led our interim manager to the next question.

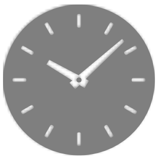
Do we have the right knowledge? It seemed almost grotesque. Like so many others, our client company was in a state of constant change. Something's been changed all the time.

It is important to keep the day-to-day business on course in conjunction with a hectic pace of activity that absorbs everything and which has remained exclusively focused on technical and organizational aspects. The independent position of the interim manager raised a question which fundamentally challenged the previous form of the business model.

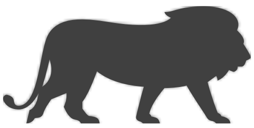
João and Fernanda gained prestige and received votes.

The following percentages represent the global composition of the **Complexity Cluster** which we collected using our 360

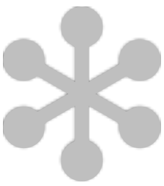
degree analysis tool. It is based on the analysis of processes and competencies. The percentages were calculated on the basis of process analyses and intensive, periodically repeated structured employee surveys.



Decision making is slow 74%

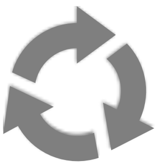


exaggerated hierarchy 59%

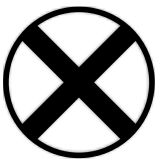


Competence overlay in the organization 66%

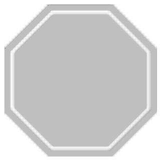
functions partly unclearly defined 51%



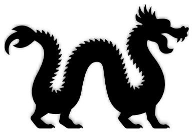
processes were never adapted 56%



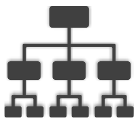
internal standards are circumvented 52%



from the second hierarchical level, the tactics and strategy of the company are no longer known 68%



contradictory goals, objectives unequal to tactics and strategy, goals are not lived, processes partly contradict goals 61%



excessive bureaucracy 84%

Do we have the right people? The people, it is assumed, are in their positions, because they can do everything necessary for it. At the end of fiscal year 2015, Group Management had had a wave of layoffs carried out, declared it as a restructuring and built the "new" organization around the remaining people. When the organization was redesigned in the 2016 financial year, it was clear that executives who delay the necessary process and systematically demotivate employees were infinitely expensive for our customers. An attempt was made to find new tasks for them. In some cases, there was no alternative but to part with these employees. If this consistent step had not been taken, cynicism and convenience would have spread throughout the company.

Do we have the right instruments? From experience, the interim manager knew that more than 90% of those involved spoke about the instruments, but not about the prerequisites when and under what conditions an instrument or method can be successful. If changes do not succeed, many managers usually claim that the instruments and methods are not suitable. The Interim Manager achieved appropriate adaptation by simplifying the methods and instruments in a robust and sensible way, and the participants were encouraged to accept positively.

Do you find change management difficult? The interim manager knew from his experience that it is not a problem to make mistakes, but to change something half-heartedly and not to constantly search for new insights. No employee would have resented the use of an instrument or method that proved inappropriate. However, these employees would not have forgiven them if something had been introduced just because it was chic without a proper understanding. That would only mean one thing: not to make any effort with the employees. At this point, the interim manager brought the local trade union representatives on board.

The change process was not given a clothed-sounding project name, but the problems were clearly identified by name and broken down to the simple causal level.

The most massive problem of the change process was the need to bring the different nations and specialist functions from the matrix organization under one roof. At the same time, specialists from Germany, Spain, Mexico, USA and Canada were engaged in the plant. The different communication codes, i. e. direct versus indirect communication, accents and fluency in the English language, different understandings of hierarchy and authority as well as contrary cultural norms brought new barriers every day. The global matrix organization leads to the grotesque situation that the production specialists tried to achieve optimization without integrating the purchasing department and quality assurance.

In summary, four fundamental goals were jointly developed and implemented:

1. The **Contingency Plan**, adopted at the beginning of the third quarter of 2016, ensured that 27% of the accumulated total loss could be offset by the end of the financial year.

2. The **budget** for the coming financial year was revised and **adjusted to the new realities**.

3. Production functions with a high strategic factor for quality assurance, such as e. g. a paint shop for cockpit parts, were subjected to an **in-house process** and re-integrated into the value-added chain of self-generation.

4. A **strategic plan to regain development capacity** has been designed and implementation started immediately. The plan envisages that the company would initially have to shrink significantly, since the margin could no longer be achieved with the parts for the old models of the main customers and the models would all expire within the next three to five years. At the same time, the development department is to be rebuilt and integrated internationally into the client's value creation network in order to successfully participate in the new models cycle, including newcomers to the Brazilian market, in about two to three years' time. Afterwards, a new growth course can be considered. To this end, planning began to plan the sale of the old and oversized factory and relocation to a new industrial cluster with the necessary infrastructure.

Conclusion. The economic market conditions of a seller's market during the last boom period of the Brazilian automotive industry have put traditional manufacturers, including the supply chain, in a certain **decadence**. The aftermath of the international financial crisis has led to a short-term motivational mindset and contributed to a **self-destructive cost reduction**, resulting in a loss of competitiveness.

The causal chain of an **overly complex company** had once again become apparent and could be adapted to the new realities at the local level:

1. The **personal perception** of employees shows that work is not productive.

2. the **motivation** of the employees decreases constantly, the number of sick days increases.

3. The **speed** of bringing a new component onto the market falls.

4. The **costs** of bringing a component to production maturity increase significantly.

5. **Customer satisfaction** and **delivery quality** are dramatically decreasing.

Result: The financial result, profit and cash flow deteriorate steadily.

The client's internal situation was so bogged down that only an independent interim manager with the appropriate experience and robust resilience as well as a broad understanding of the Brazilian reality and sensitivity for the communication code of Northern Europe and North America could initiate a genuine change management process and successfully carry out painful reorganizations.

After this period, a real transformation process can be implemented and carried out during 2018 and 2019. *(PMT)*

For more information:

Frank P. Neuhaus
Managing Director
iManagementBrazil Ltda.
São Paulo - Brazil

Tel. São Paulo:
+55 11 5522 41 98

Mobil: +55 11 9103 91 49

@mail:
frank.neuhaus@imbrazil.com.br
www.imanagementbrazil.com.br