

7 keys to get the auto industry running again

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The automobile industry, once a model of business administration, is now mired in mismanagement scandals. How can it regain its prestige?

Many of the best business concepts originated from the auto industry; it's where management gurus such as Alfred Sloan and Peter Drucker first took their ideas out for a test drive. The industrial, social and economic weight that this industry carries is irreplaceable in the medium term.

IESE Prof. [Pedro Nueno](#) notes this influence in "[Management in the Auto Industry: Observations and Practices for Good Governance](#)", published by the Technological Institute Foundation for Security in the Automobile (FITSA).

In Europe, the auto industry represents around 3 percent of GDP. Europe produces more than 20.8 million motor vehicles, representing 32 percent of world production. It provides numerous jobs, both in manufacturing vehicles and components, and in related sectors such as providing raw materials, sales and road transport, which generate 10 million additional jobs alone.

The onset of a crisis

Yet the signs of decline began in the year 2000. Everyone was affected. Management practices that were once held up as a model were now being questioned from a market standpoint or for compromising their formerly prized ethical standards.

The first decade of the 21st century has been marked by the emergence of unprecedented phenomena. On the one hand, the entry of new countries into the European Union, and the growing activity of local manufacturers in Asian countries, opens new markets and raised demand for new products. On the other hand, the low cost of labor in Eastern Europe, China, India and other Asian countries is sending much of the production there. There is excessive worldwide production capacity.

Constant innovation and frequent changes in the business models available are becoming the means of market competition. The industry invests 20 billion euros annually in R&D, representing 17 percent of overall R&D investment made by companies - more than any other industrial sector.

Nevertheless, it is not clear whether the end customer actually needs this supply, nor if they are even willing to pay for it.

What's more, the industry is going through a moment of extremely low profits, likely the result of aggressive and perhaps excessive competition based on price. Unlike companies from other mature and concentrated industries, such as food or distribution, the auto industry has not found a way to adequately defend its margins.

The industry has become highly concentrated; power is amassed by a handful of manufacturers. Given this, manufacturers are exerting considerable pressure on suppliers. They want lower prices, they are making specific demands on the location of their facilities, they want access to internal management information - a particularly touchy issue considering the general lack of transparency when it comes to internal transfer costs.

Moreover, the restructuring processes that are taking place seem irrational. Many companies have applied readjustment plans: Nueno believes this is something we will see more of in the future. Yet when doing so, companies opt for reducing production in plants that are further from decision-making centers, as opposed to operating where costs are higher.

New management model

Nueno has debated the industry's problems with all concerned parties: managers of assembly companies; parts manufacturers; distributors and companies that carry out support functions in Spain, the rest of Europe, America and Asia; people from the government arenas of Spain and the E.U.; as well as those with responsibilities at financial institutions and capital markets. Taking all these views into account, Nueno calls for a changed management model. The good news, he says, is that we don't have to reinvent the wheel. There are already good examples to follow, namely Honda, BMW and Toyota, which he believes offers the best model of good management sustained over time: continuous improvement, cooperation with suppliers, prudent innovation, commitment to quality and a strategic approach focusing on

the long term.

Seven recommendations

Nueno acknowledges that governments do have a role: It was government regulation, for example, that led to 30 vehicles made in 2006 producing fewer contaminating emissions than one car did back in 1986.

However, he cautions, managers are ultimately the ones who must run their companies. Government bodies need to understand the importance of the industry and give them the opportunity to apply their regulations themselves.

To help with this task, Nueno makes seven recommendations that could help restore the prestige once enjoyed by this industry.

With regard to the relationship between suppliers and customers, it is important to:

- Not intervene in the strategic decisions about their geographic location.
- Not establish limitations on the use of their intellectual property.
- Not demand access to their internal management information.
- Not impose unilateral costs, price changes, discounts or make inventory demands differing from those stipulated in closed supply contracts.

And, at the general level, he advises:

- Have the internal auditing units pay special attention to detecting irregularities in the supplier-customer relationships.
- Drive internal competition by applying informational transparency with regard to transfer pricing.
- In decisions involving closures or drastic cutbacks in industrial capacity, make the key criteria be protecting the company's long-term competitiveness and destroying as little shareholder value as possible.

In short, it is about managing in a professional and ethical manner, and doing so with transparency and within the framework of good.

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