Managing Through the Downturn

A new Capgemini study examines winning strategies adopted by manufacturing companies during the last global downturn and considers how they can be applied in the current economic environment.

An economic downturn usually leads to major industry upheaval, challenging the established standards and best practices, and testing an organization's key strategies and processes. Some companies manage not only to sustain through tough times, but also to emerge stronger after implementing certain strategies. Many others end up weaker or go out of business.

During the last downturn in 2001-2002, all segments of the manufacturing industry were affected. As companies emerged from that recession, there were clear winners and losers. Capgemini has conducted an analysis of how different manufacturing companies responded in the last downturn and what key strategies and measures enabled successful businesses to withstand the recession.

In today's economic downturn, manufacturing companies need a framework to guide them as they make key strategic decisions. So, what lessons can be learned from the previous downturn to help improve companies' chances of survival today?

Winning Strategies in the Downturn

While there was no single winning strategy adopted by the leaders across all segments, our study identified a number of common approaches used by the successful companies. Many of the winning strategies incorporated cost-reduction initiatives, but others focused on people and products. These strategies help provide clues to steps that can be taken in today's economic environment.

1 **Leaders were able to considerably reduce the cost of goods sold when compared to their peers.** The downturn was looked upon as an opportunity to examine the entire cost structure. Areas were identified for cost reduction through centralization, rationalization and standardization. Rigorous follow-up, adherence to plans and high employee motivation helped leaders to achieve their goals.

For example, to reduce costs an automotive manufacturer focused on non-core operations by setting up shared services for its financial back office and its central global purchasing office, which handled requirements for Japan, Europe and North America.

In another case, by implementing the Kaizen method of continual improvement five days a week, a U.S. aerospace supplier was able to reduce its working capital inventory by 40% and cut lead times to 4 to 5 weeks, down from 10 to 12 weeks, thereby reducing costs.

A global computer manufacturer reduced costs by adopting just-in-time manufacturing to improve processes. And by cutting out retail channels the company was able to sell directly to customers, thereby responding faster to customer needs, which saved time and money.

2 Although leaders focused on reducing costs, at the same time they invested in research and development (R&D) and building brand awareness. Despite cost pressures, leaders continued to invest in new product development, product launches and strengthening/repositioning their brands. This helped fuel demand for their products and positioned them as strong players for the upturn.

In one example, a global automotive manufacturer took steps to improve its brand image by developing a program to give its U.S. dealerships a standardized futuristic look. Each of its 1,000+ dealerships went through a remodeling of both the exterior and interior.

Another automotive OEM reorganized its R&D operations, giving the regions more responsibility for the entire product line while creating a global integrated organization.

In the aerospace segment, a Brazilian-based manufacturer was able to emerge stronger from the economic downturn by diversifying through investments in the smaller jets segment to tap into increasing demand. A campaign was launched to promote these new aircrafts to operators in 25 countries.

Contrary to the industry trend at the time, a South Korean high-tech company increased its marketing spending to 3% of sales revenue to ensure a unified premium brand positioning regardless of the type of retail outlet and country.

3 While many companies focused on business innovation in the last downturn, leaders differentiated themselves through process and people management. Leaders re-examined their processes to identify areas for improvement by involving employees across all levels and boundaries. To ensure high motivation among employees, constant efforts were made through communication, training in knowledge-building and other initiatives, reassuring employees of management commitment and belief in the company.

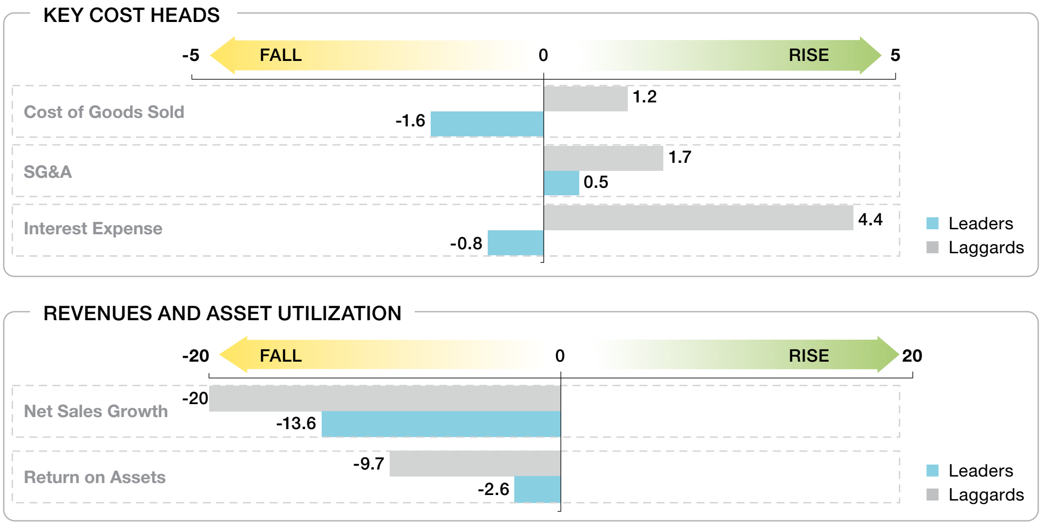
For example, an aerospace manufacturer launched an integrated in-house communications program to build a strong employee network around the world. Employees were able to update their knowledge to match the high standards of the aircraft manufacturing industry. A "good ideas" program generated more than 2,334 ideas, that led to cost reduction, improved products and processes, and also generated savings.

A global computer manufacturer instituted a new leadership program, primarily for people managers, focused on developing a winning spirit culture. A global training curriculum for non-managers was refined to help employees learn about topics that were relevant to the business and contributed to the bottom line.

4 Leaders succeeded in leveraging technology to improve efficiency and reduce costs. Successful companies leveraged lean manufacturing methods and tapped into technology to enable collaboration with suppliers and customers, as well as to provide customers with a unique experience.

Financial Parameters of Leaders and Laggards in the 2001-2002 Downturn

Winning companies emerged successfully by adopting differentiated measures and strategies.



Source: Capgemini, Manufacturing Center of Excellence

For example, a French-based automotive supplier improved its supply chain efficiency and achieved savings in procurement by joining five other industry players to develop a common web platform.

An aerospace manufacturer shifted from traditional manufacturing methods to digital manufacturing, which resulted in the reduction of manufacturing cycles by 15% and configuration cycles by 25%.

A U.S. high-tech manufacturer transformed its IT outsourcing contract from a project-by-project service delivery model to a dedicated center model. More IT operations were outsourced and there was a consolidation and renegotiation of contracts for mobile assets, personal computers, web hosting and other technology outsourcing initiatives.

Another manufacturer introduced a number of extranet technology systems, providing customers, dealers and suppliers with better access to product information, the ability to request product configuration, order online and share knowledge with the company's employees.

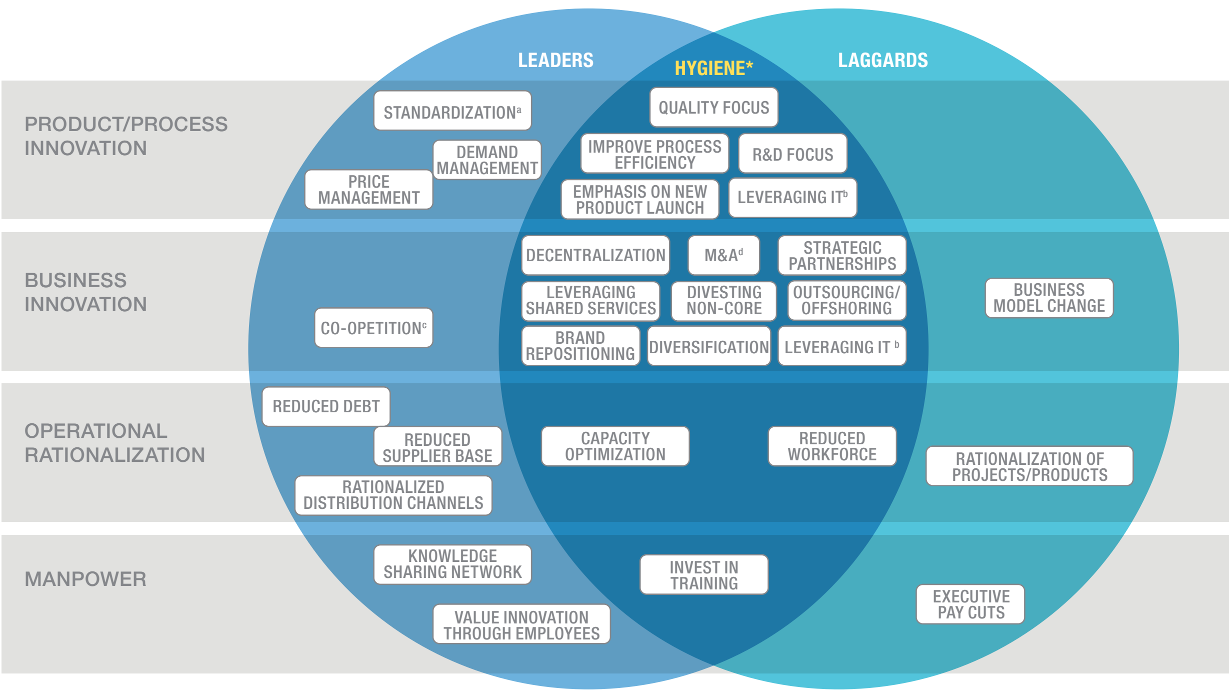
Laggards: What Went Wrong?

While winning strategies from the previous downturn provide valuable ideas that can be leveraged in today's climate, equally useful is an examination of common mistakes made by companies that suffered. Our research identified a number of these areas, including:

- **New products:** The laggards failed to successfully launch differentiated new products that offered customers the price and value that they were looking for in the downturn market.
- **Product rationalization:** At the same time that they struggled with new product launches, many laggards also failed to reassess their full product lines and make difficult decisions about product rationalization.
- **Response time:** Companies that suffered in the prior downturn failed to respond quickly to rapidly changing market conditions and buying behavior, such as down trading by consumers. As a result, they were slow to adapt their product mix and pricing structure.
- **Investment choices:** In many cases, the laggards continued to invest in under-performing, money-losing areas of their business rather than reassessing and adjusting their investment decisions.
- **Inventory:** Less successful organizations typically were slow to reduce their production rates, resulting in large inventories that failed to move even at lower prices.

Winning Measures Centered Around Process Innovation and People Management

Business Innovation, though not a panacea, was extensively tapped as well



NOTES: * Hygiene refers to measures adopted by both leaders and laggards during the downturn
a. Standardization with regards to parts and platforms. b. IT – Information Technology. c. Co-opetition in R&D. d. M&A – mergers and acquisitions
Source: Capgemini, Manufacturing Center of Excellence

Conclusion: Learning From the Past

Each of the companies examined in our study was in a challenging situation with respect to their business in the earlier downturn. However, organizations that emerged stronger were better able to understand the economic deterioration, and made focused decisions and very specific implementations.

With a better view to the benefits derived from past actions, companies today need to take a closer look at the key strategies and actions adopted by the leaders and laggards of the last downturn. With this information, manufacturing executives can:

- Re-examine their current strategies and actions in light of past experience.
- Incorporate some of the learnings from the best practices of the leaders and avoid the mistakes of the laggards in their current strategies.

This paper covers just a few examples from Capgemini's extensive research. We would be happy to provide a more detailed view of the complete study and explore how the best practices uncovered may be applied to your own business in today's challenging environment.

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Methodology

The research was conducted by studying a sample of over 100 companies in the automotive, aerospace and defense, high-tech and general manufacturing segments. Researchers in Capgemini's Manufacturing Center of Excellence ranked companies based on their average RONA (Return on Net Assets) within each segment. The top two companies (leaders) and the bottom two companies (laggards) were then selected for further in-depth analysis.

The analysis was based on metrics in three key areas:

- **Operational management:** Metrics such as cost of goods sold, SG&A expenses, R&D expenses, interest expenses and net profit margin were analyzed to gauge operational efficiency.
- **Cash management:** Analysis of ratios such as receivable days, payable days and days inventory outstanding were reviewed to understand each company's cash management strategy.
- **Resource management:** A downturn is often marked by a reshuffling of resources (both assets and manpower), so ratios such as revenue per employee and return on assets were also analyzed.

A percentile comparison of these metrics across the downturn period was used to provide upfront assessment of each manufacturer and to identify key focus areas. To deepen our understanding of the driving factors for success or failure of the companies, differentiating measures and strategies adopted by the winning companies were identified. Key measures taken by each company were grouped based on their final impact into three categories:

- **Sales growth:** measures taken to grow the revenues of the company.
- **Cost cutting:** measures taken to reduce costs of the company.
- **Others:** measures taken to help address the downturn, such as people management, training and culture, dispositions of companies and increase/decrease in debt.

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