

# Driving home the benefits.

How finance transformation can re-energize the Canadian automotive industry

The automotive Chief Financial Officer reviews the supply chain, considering innovative ways to reduce costs. The day continues with an assessment of the risks and overall value proposition of a new lighter product line that can also reduce emissions. Next, a discussion with human resources determines how to better facilitate communication between the research and marketing teams.

Today's automotive CFOs are strategic advisors to their organizations and as a result, their roles are more complex than ever. Some of the world's leading companies are using excellence in finance management as a key driver to improve, transform and sustain business performance. Canadian automotive companies can leverage these best practices and reap significant rewards by taking the necessary steps toward transforming their enterprise.

## Rethinking the automotive industry

Only a few years ago automotive suppliers could exclusively supply to any one of the Big Three auto manufacturers and count on consistent demand. During those days when cars sold more easily and fuel was inexpensive by today's standards, consumers were not all that concerned about gas mileage and emissions.

Trends and demands have shifted since then and, as a result, the automotive industry is transforming rapidly. To remain competitive today, automotive companies must transform their business. In fact, many must transform just to survive. While some steps seem clear, others may appear to be beyond the realm of a traditional automotive company. That's the trick: becoming a "new style" automotive company. While there are several options to consider, many companies are beginning to use finance transformation as a key success factor.

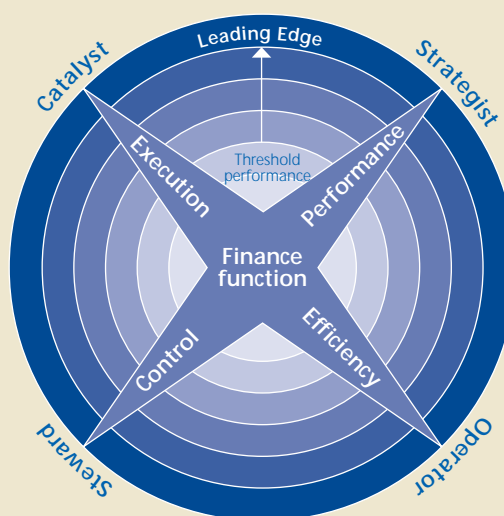
What has changed? Overall consumer spending and consumer confidence in the market now play a big role in how consumer dollars are spent. Market share has been shifting away from the Detroit Big Three in favour of Asian and European manufacturers. Original equipment manufacturers (OEMs) are producing a greater variety of vehicles and squeezing these new nameplates into smaller market



needs of different stakeholders, balance capabilities, costs and services, balance innovation with protecting assets, and provide leadership in strategic business model transformation.

Financial transformation is defined as improving stewardship, performance and control of the company so that CFOs and their performance organizations can have greater impact on strategy formulation and execution across the enterprise.

### CFO leadership framework



niches. These issues have had a huge impact on Canadian automotive suppliers. The challenge of increasing costs of raw materials and the appreciating Canadian dollar has placed these suppliers into a position where they are facing dramatic diminishing returns.

Automotive companies must change their business models accordingly. They must rethink the market, rethink their product line, and rethink production. Then they must strategically develop a new plan and put it into action. Finance transformation is a critical part of this new plan, which means new and expanded roles for people working in finance. In particular, the role of the automotive Chief Financial Officer (CFO) is expanding to become an integral part of business strategy, marketing, innovation, product development, regulatory compliance and all other key aspects involved in running an automotive company.

### The changing role of the automotive CFO

Traditionally, automotive CFOs oversaw accounting and made sure finances were stable. Today, however, the role of the CFO is much more significant. Incorporating finance into innovation, production, human resources, marketing and the supply chain allows automotive CFOs to accomplish many important functions. They can balance the

The challenge for Canadian automotive CFOs is to accomplish a growing number of sometimes conflicting tasks in this increasingly complex industry. The role of the CFO has expanded into four distinct operations:

#### Steward – Protect and preserve the organization's assets

This traditional role involves the identification, assessment and minimization of risks – including strategic, operational, regulatory, legal compliance, environmental and health & safety risks. Accomplishing this task allows the CFO to gain integral insight into daily operations of every area of the business, which is imperative for the success of the CFO's other three roles outlined below. This role also involves ensuring quality and accountability, which can be challenging when paired with the Operator's goal of cost reduction.

#### Operator – Balance capabilities, costs and service levels to fulfill the finance organization's responsibilities

This role is about increasing efficiency, reducing costs and implementing change. After basic inefficiencies are dealt with, further improvement requires more complex thinking. This may involve consolidating operations, off-shoring, modifying business processes on the shop floor, streamlining steps in the supply chain,

## The barriers to finance transformation – Is your company inhibiting its own success?

Using traditional business models and enforcing established roles can hold back a company's growth in the rapidly changing automotive market. Does the following sound like your company?

- 1. Believing the market will bounce back.** The automotive industry has experienced a fundamental shift. Consumers may continue to love their vehicles but fossil fuels will never be cheap and plentiful again. Consumers buying a car think about operational costs as much as sticker price so the way vehicles are developed, built and sold must change. With OEMs from China, India and Japan taking strong positions in the global market, the days of U.S. dominance of the automotive industry are also over. Canadian companies must develop more varied alliances to be competitive.
- 2. Closed thinking about how the company should operate.** Just because a business model has worked for many years doesn't mean it is the best business model for today. Japanese automotive companies engage in global business model transformation, resulting in increased profits and expanded market share. Their business model is highly collaborative, with the finance function involved in both corporate and marketing strategy. As well, there is a focus on innovative thought and long-term planning to ensure they survive on-going market swings.
- 3. Closed thinking about the role of finance.** Basic stewardship and accounting are important but, to implement a fundamental change in the company's business model, the role of finance must be drastically expanded. Without finance involvement in strategy, innovation, marketing, the supply chain, service and every other aspect of the business, an automotive company will face an uphill battle in enterprise transformation. This is because finance determines what the company can afford and what makes most economic sense. To maximize a company's profitability, finance should be integrally involved in all levels of company decision-making.

or changing the attitude of marketing and sales. The goal for finance is to increase shareholder value, and achieving this requires direct knowledge and involvement in the basic operations of a company.

### **Strategist – Provide financial leadership in determining strategic business direction and in aligning financial strategies**

With a clear understanding of every area of the company and a financial perspective, the CFO can determine the best route toward expansion, growth and reaping the rewards of business opportunities. Working together with other executive functions, finance can target new markets through innovation, diversification and globalization. The automotive CFO should also be a primary player in talent management – developing policies to attract and retain effective talent, ensuring their performance measures are directly linked to enhancing corporate value, and building a collaborative environment where knowledge is shared and information transfer is streamlined. This also allows the CFO to build a better system of networking that will help spread important messages throughout the company.

### **Catalyst – Stimulate behaviors across the organization to achieve strategic and financial objectives**

Sometimes this role will appear to be in direct opposition to the traditionally risk-adverse role of Steward. However, recognizing the need to adapt to the changing market and industry, CFOs must adjust their thinking to embrace higher levels of risk and uncertainty. This does not mean jumping at any new idea. The role of the CFO is to assess risks and nurture those that are most promising. However, in a rapidly transforming business environment, many risks cannot be fully assessed. Still, the CFO brings a level of business intelligence that can stabilize and balance the insights of the other executive functions when decisions are being made. The automotive CFO can demonstrate whether business interests are aligned with new proposals, and extrapolate to determine the potential for increased profitability and long-term growth if these new measures are adopted.

## What happened? The challenges facing the Canadian automotive industry

The Canadian automotive industry faces the same global pressures that are causing automotive companies worldwide to rethink their business models, which include:

- **Diminishing consumer spending.** This reduces profits as sales volumes approach the break-even point for many OEMs, with a trickle down effect for suppliers.
- **Increasing raw material costs.** This affects every part of the industry from the supply chain, to OEMs, to aftermarket producers.
- **Increasing fuel costs.** This affects costs for the transportation of materials and finished products, and also affects consumer spending. The increase in the cost of fuel has also affected the mix of products being sold, shifting from larger to smaller cars. This has been one of the quickest shifts in demand the industry has ever experienced.

Canadian automotive manufacturers must also cope with challenges that are unique to this country. The higher Canadian dollar translates into lower profits when selling to a largely U.S.-based market. The higher dollar also means Canadian products are relatively more expensive to U.S. buyers. This results in financial pressure that induces U.S.-based automotive manufacturers to purchase from American suppliers.

In addition, the recent Union of Automotive Workers (UAW) agreement removed a provision requiring companies to provide for the health care of their workers. Canada has government-funded universal health care, so historically Canadian companies were relatively more competitive prior to this new agreement since those costs were never incurred by Canadian companies. Now, Canadian companies may need to consider giving up other worker benefits in order to remain competitive.

Another issue that Canadian automotive manufacturers face is the way they are positioned to supply their customers. This depends on the kind of supplier the company has chosen to be. In studying and working with many automotive parts suppliers, Deloitte has developed three categories into which suppliers generally fit, which are:

- **Diversified suppliers.** Companies that supply parts for many areas of the vehicle. As demand and industry conditions change, this group is somewhat insulated, losing on some parts but gaining on others.
- **Specialists.** Focusing on a specific part of the vehicle, these companies offer highly engineered and specialized products that OEMs would have a more difficult time finding otherwise.
- **“The Turbulent Majority”** Comprising between 60 and 70 percent of the industry, these remaining suppliers are in a tenuous position. They primarily produce a limited range of products and tend to rely on a single purchaser, usually one of the Big Three automotive manufacturers in the U.S. As fewer consumers purchase Big Three vehicles and the cost of raw materials increases, profitability gets squeezed from both sides. If they must increase their prices, or even if their prices rise as a result of the higher Canadian dollar, these companies become less attractive as suppliers. This makes suppliers based in the U.S. relatively more attractive than those based in Canada, resulting in a loss of business for Canadian suppliers.

### The solution: transforming the enterprise

So what's a Canadian automotive CFO to do? What are the steps a Canadian automotive company should take to transform the enterprise and what can the CFO do to effect the change? The CFO must combine its four roles and inspire, strategize, direct and steward the company to transform:

**The company must innovate.** It must create the high-functioning, efficient, green and environmentally sound products that the market demands. According to market research company DesRosiers Automotive Consultants, more than half of all retail buyers in Canada

in 2006 bought a small, fuel-efficient vehicle. This is a dramatic rise from 34 percent in 1997, and experts expect this market to continue to expand. Developing inputs that increase the cost-effectiveness of the end product gives any company a competitive advantage. Consumers are increasingly concerned with environmental factors so being recognized as a company that help automakers (and hence consumers) decrease their environmental footprint can make products particularly sought-after. The challenge, with research and development going in many directions (from hybrids to fuel cells to ethanol to replacing plastic with natural compounds) is to find an effective, affordable solution that will result in fuel-efficiency, low emissions and overall excellent performance in the long run.

**The company must streamline production.** A comprehensive process improvement program can seriously increase efficiency and, thereby, lower overall costs. With the cost of raw materials increasing rapidly, and energy costs spiking, there's no excuse for any waste in the production process. Canadian automotive manufacturers are already highly efficient. At 21.3 labour hours per vehicle, Canada is 6.4 percent more productive than the U.S. and 28.3 percent more productive than Mexico, according to the 2006 Harbour Report, the annual study of automotive manufacturing performance by Harbour Consulting. The challenge is to go beyond basic production efficiency to rethinking the process of the entire enterprise, including the supply chain, distribution and sales choices.

**The company must diversify its client base.** Canada is dependent on foreign markets, exporting more than 90 percent of its output to the U.S. Relying on a single Big Three automotive manufacturer is no longer reasonable or good for business. These manufacturers are producing fewer cars, and that means they are purchasing fewer goods from suppliers. Auto production in Canada decreased by 115,000 vehicles in 2006 and output is expected to decline further in 2007. Parts manufacturing is down 11 percent from its peak in 2003. With economies of scale, many suppliers only make a profit on the sale of the larger quantities they were accustomed to selling. For these suppliers, the result of decreased sales might be much worse than decreased profits. It may mean no profit whatsoever or even losses.

**The company should diversify its product lines.** Not only does diversification help Canadian automotive companies tap into new and growing markets, it helps ensure they can weather changes in demand. As demand from fickle consumers waxes and wanes, the supplier of a larger range of products is better insulated because, while some products may generate losses, others will be profitable. At all times, the company can work on survival strategies instead of constantly being in a tenuous position due to dwindling demand from a small product line.

**The company should enter the aftermarket and other related industries.** In a series of related steps, automotive suppliers should consider diversifying their product lines by entering the aftermarket and other related industries. In North America, the demand for aftermarket products is growing while the demand for vehicles is diversifying. Expanding product lines to related products requires

## How finance transformation has worked in other industries

Owens-Illinois, the world's largest manufacturer of glass containers, used finance transformation as the final part of a three-step effort to modernize its business. The company recognized the importance of aligning operational strategies and investments with overall drivers of business performance such as revenue growth, operating margin and asset efficiency. They put long-term growth ahead of short-term earnings per share, which investors recognized as a good idea. They recognized that finance transformation is not a magic bullet that will work overnight; it is part of an overall on-going business transformation.

Multi-national chemical giant BASF used finance transformation to make the marketing, sales and service organizations of their Chinese operations more customer-focused. To do so, its finance team created a set of "customer lifetime value" metrics which were then linked to compensation. The new system resulted in higher revenue growth because the sales force had incentives to focus on customers that were more likely to buy. Better service of the right clients resulted in higher customer retention and long-term increased profitability.

The same concepts can be applied to the automotive industry where customers have traditionally been brand loyal. However, with the many industry changes underway today, brand loyalty is quickly eroding as a result of the improved and increased product offerings from foreign competitors. In fact, research from DesRosiers predicts the Big Three will continue to lose market share as competition becomes increasingly strong and the market fragments into a multitude of brands. The research also found that more than 30 percent of the vehicles sold by Ford, General Motors and DaimlerChrysler (as it was then known) were based on nine-year-old technology, as opposed to the five-year-old technology used by most imports built in North America.

For Canadian automotive manufacturers, the solution is to adapt to changes in the industry and to changing consumer demands. They can do this through innovation and developing a reputation for excellence and cost-effectiveness. They can open their company to more markets and more opportunities. They can focus on long-term growth. While the size of the automotive industry has decreased in North America, the global market for vehicles has expanded. Canadian automotive manufacturers can leverage financial transformation to focus on new markets and new demands to help them reap the rewards of the global economy.

research into understanding and reaching this new market, however the potential gains can be considerable. As Canadian manufacturers continue to lose market share to low-cost off-shore supply shops, Canadians must focus on developing specific competitive advantages related to factors such as service and style.

### Steps to a successful transformation

- Innovate
- Streamline and consolidate production
- Diversify the client base
- Diversify product lines
- Enter the aftermarket and other related industries

### Embrace the transformation

Canadian automotive companies must take the necessary steps to leverage their assets, identify what is essential for the changing market, innovate to develop a winning product line, and take full advantage of both domestic and global opportunities. The steps are clear: assess the company, devise a plan and implement solutions. By taking Deloitte's global survey, *Transforming the Enterprise Through Finance*, [www.deloitte.com/ca/financetransformation](http://www.deloitte.com/ca/financetransformation), Canadian automotive companies can benchmark their company against best practices and develop a plan to implement optimized and comprehensive solutions.

The plan incorporates systems, technology, insourcing, outsourcing, talent, innovation, marketing, the supply chain, distribution, pricing, taxation, legal issues, regulatory matters, communications and all other factors that affect the enterprise. For all of these factors, the finance role is a key driver.

The challenges for the Canadian automotive industry are serious but not insurmountable. Despite the decline in market share for the Big Three automotive manufacturers, the global market is growing. DesRosiers forecasts additional growth in sales of 15 to 20 percent in the next decade. The question Canadian auto manufacturers must ask themselves is how they can get those added sales. Much of enterprise value is based on investor expectations of the return on future investments so embracing the new global industry can help any company develop confidence from investors and customers alike. Transformation is crucial and the role of the CFO in the automotive industry is central in creating a new business model that can succeed, generating sustained growth and long term profitability. ●

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