



# **What the Heck is going on in the Automotive Sector: Can other Sectors Learn from the Mistakes made in the Auto Sector?**

Dennis DesRosiers – February 17, 2010



# Two Fundamental Problems in play in the North American Automotive Sector



**First and foremost there was a  
Revenue issue ... there were  
and still are very serious  
demand Issues in the North  
American Market**

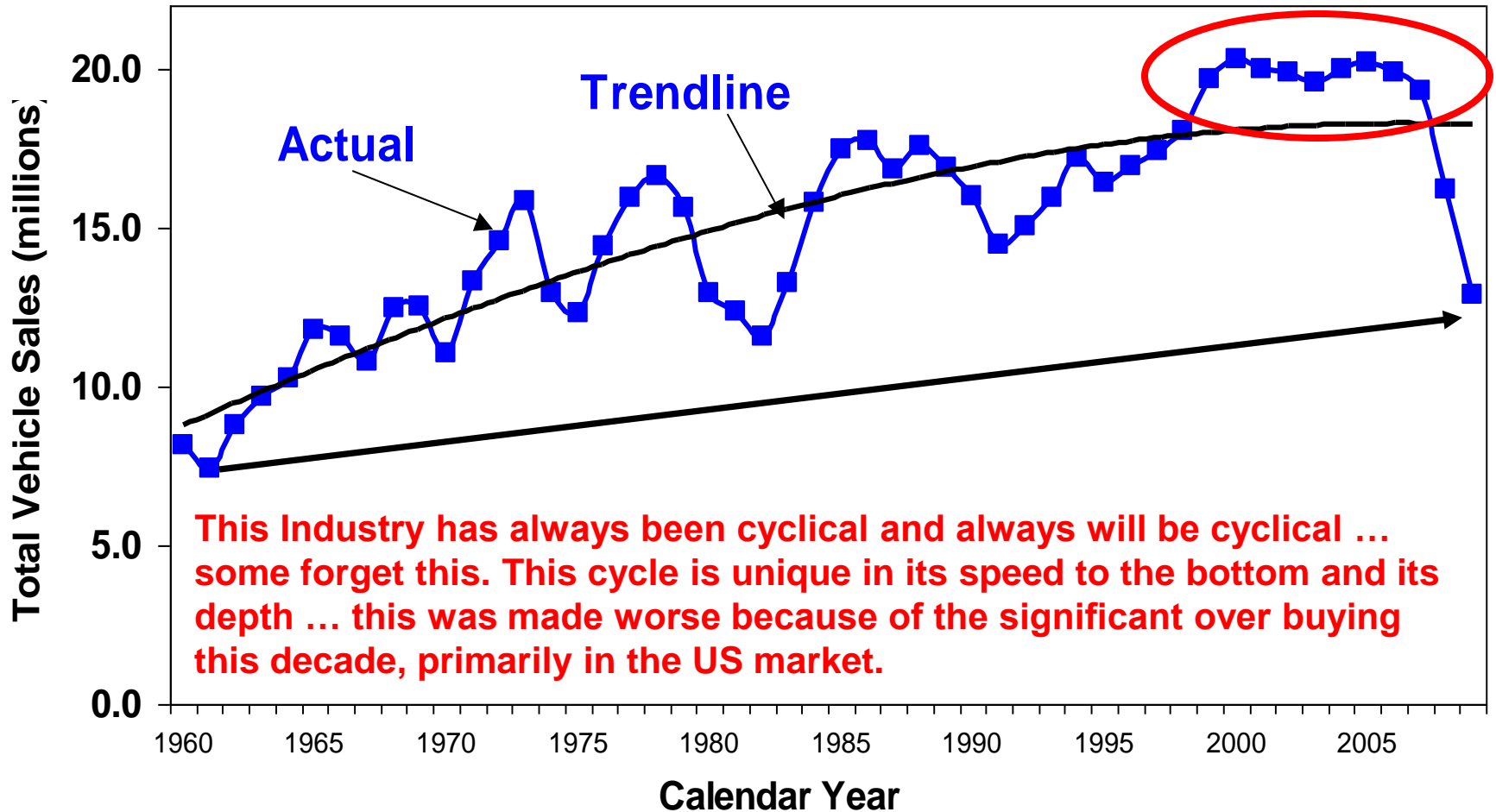


- Most of the current problems in the auto sector are the result of the the most serious cyclical downturn in the market ever witnessed
- There also are serious structural issues and they are made much worse by the current cyclical issues but the market downturn trumps all structural issues at this point
- Most structural issues revolve around “Detroit” and they became “Critical” since the cyclical downturn killed the time they needed to change their organizations

# Total North American Vehicle Sales

1960 - 2009F

Significant Over Buying  
The Great Plateau





- The current cyclical downturn emanates from a number of different sources:
  - Deregulation of the banking sector provided Americans with incredible liquidity.
  - Generous incentives, triggered by 9/11 when GM responded with their “Get America Rolling” campaign

**Americans responded and over bought vehicles  
by the millions**



- Over buying set the stage and led to a collapse that also emanates from a number of different sources:
  - Rationalization of U.S. housing market and reduction in homeowner equity ... IE: taking away the piggy bank
  - A return to more rational credit risk
  - The inability to securitize a lease/loan portfolio cutting off much of the debt consumers needed to purchase a vehicle
  - The poor economy
  - Highly levered companies

## Expect a very lean decade in the North American Automotive Sector

	TOTAL VEHICLE SALES UNITS	VEHICLE USAGE BILLIONS OF MILES	DURABILITY MILES	TOTAL UNITS IN OPERATION	VEHICLES PER DRIVING AGE POPULATION
1960-1969	95,223,800	8,684	91,934	80.6	59.9%
1970-1979	127,804,942	13,357	105,200	117.6	73.2%
<b>Percent Change</b>	<b>34.2%</b>	<b>53.8%</b>	<b>14.4%</b>	<b>46.0%</b>	
1980-1989	135,364,952	17,650	132,074	155.9	83.9%
<b>Percent Change</b>	<b>5.9%</b>	<b>32.1%</b>	<b>25.5%</b>	<b>32.5%</b>	
1990-1999	148,782,909	23,991	161,631	192.5	93.5%
<b>Percent Change</b>	<b>9.9%</b>	<b>35.9%</b>	<b>22.4%</b>	<b>23.5%</b>	
2000-2009F	161,736,876	29,148	188,079	224.3	95.9%
<b>Percent Change</b>	<b>8.7%</b>	<b>21.5%</b>	<b>16.4%</b>	<b>16.5%</b>	
2010-2019F	141,500,000	30,638	228,066	258.1	97.4%
<b>Percent Change</b>	<b>-12.5%</b>	<b>5.1%</b>	<b>21.3%</b>	<b>15.1%</b>	

• High gas prices slows usage, better built vehicles extends durability and slower driving age population growth all mean a much leaner US market this coming decade and thus a smaller market for downstream players!

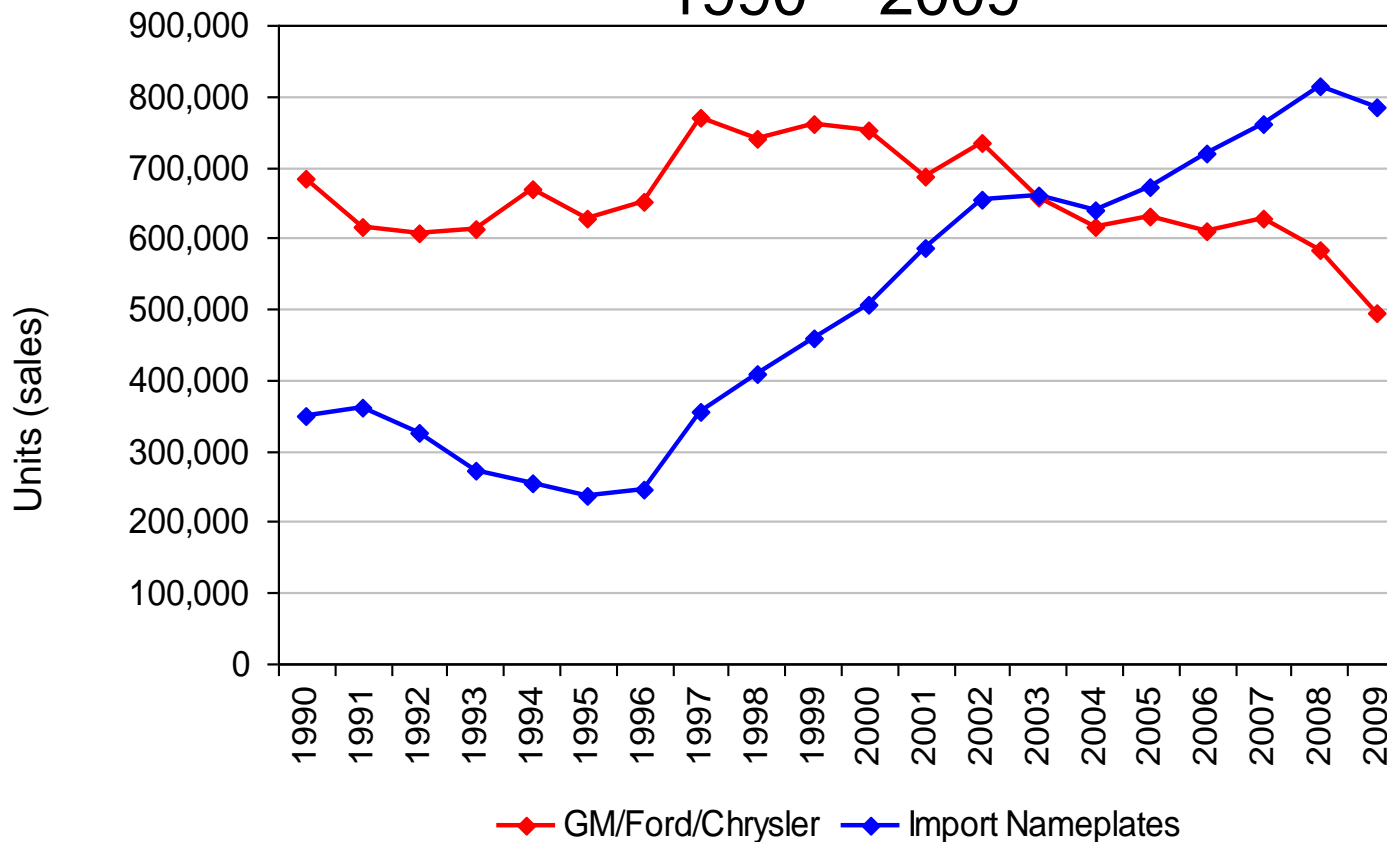


**Secondly, there were very serious structural Issues for the Detroit Three which lead to significant market share losses**



# Cdn Consumer Market – Example – Same is true in the U.S.

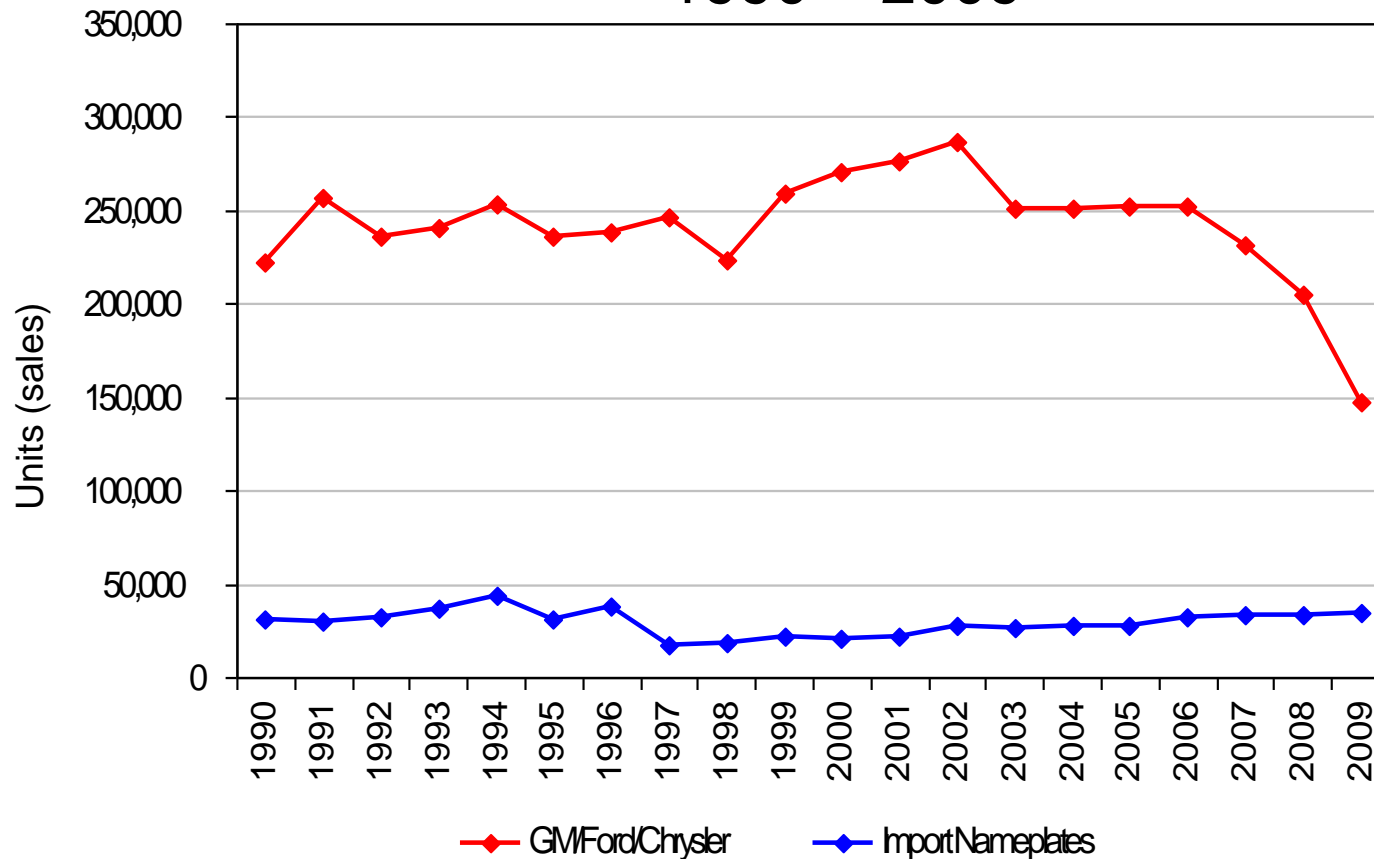
1990 – 2009



•The D-3 have lost market share for 15 years in row, so to a large extent Detroit has lost the Consumer ... this will be very difficult to get back

# Canadian Fleet Market – Identical in the U.S.

## 1990 – 2009



•The D-3 have also started to back out of fleet sales ... some of this is because they no longer need to dump under performing vehicles into fleets



## North American Production to Sales Ratio

2000	87.0%
2001	79.0%
2002	84.1%
2003	82.8%
2004	81.2%
2005	80.8%
2006	79.8%
2007	80.0%
2008	79.6%
2009	67.9%

- Fortunately, most of the increase in market share by the import nameplate brands has come from them building a substantial supply base inside NAFTA which have kept most of the manufacturing jobs inside North America

- The P – S ratio has been consistently in the 80 percent range for many years ... so import leakage is, give or take, around 20 points and hasn't really changed this decade.

- IE: This is **NOT** an off-shore import vehicle problem like some contest ...



**The Market downturn together  
with the loss of market share  
has resulted in very serious  
Issues on the Manufacturing  
Side of the Auto Sector**



# North American Production of Vehicles # of Units

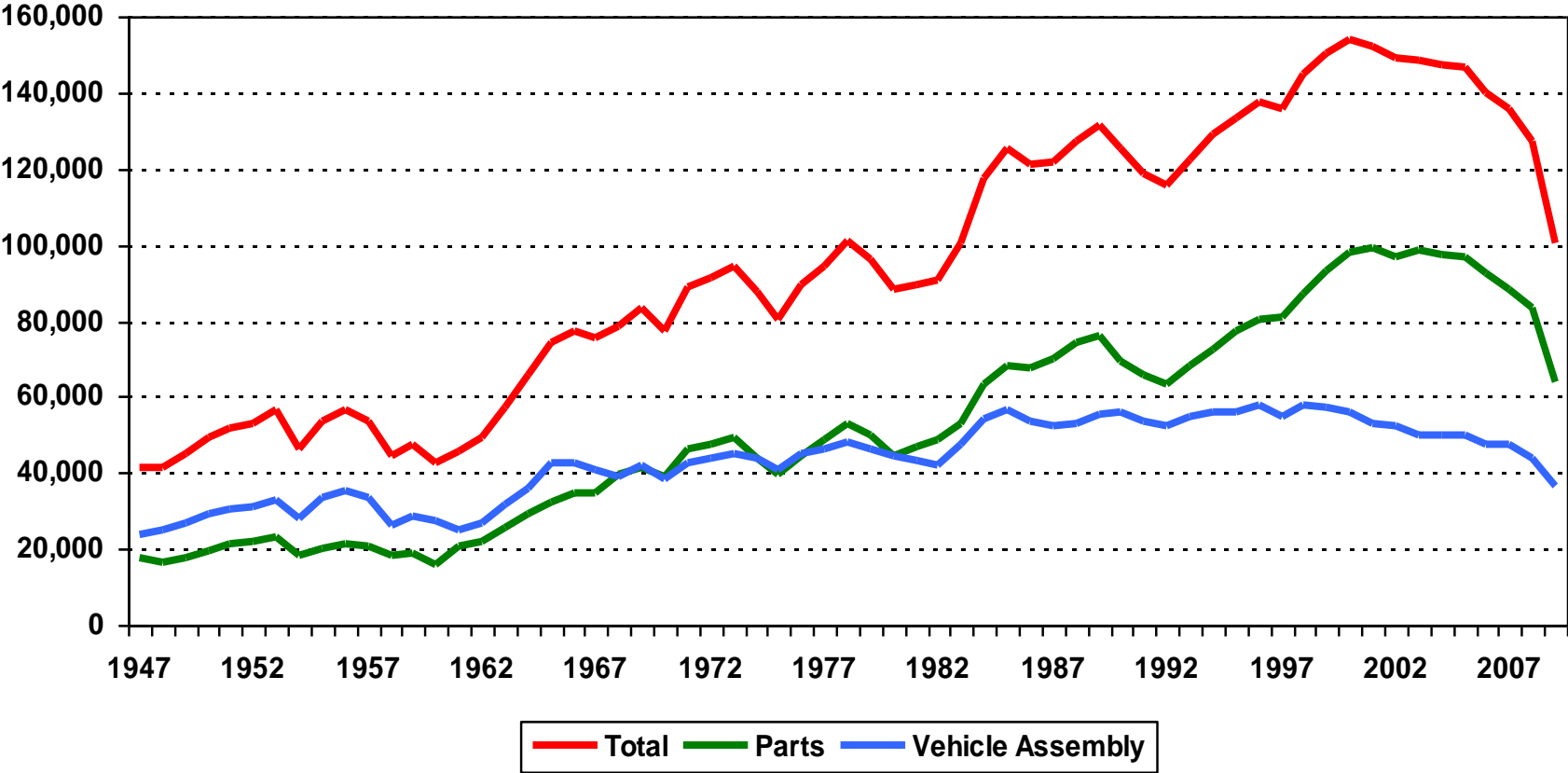
Year	GM, Ford, Chrysler Units	Share	New Domestic Units	Share
<b>2000</b>	<b>13,196,873</b>	<b>74.7%</b>	<b>4,117,212</b>	<b>23.3%</b>
2001	11,593,637	73.3%	3,997,567	25.3%
2002	12,281,894	73.5%	4,168,305	24.9%
2003	11,499,933	70.9%	4,422,906	27.3%
2004	11,060,100	68.2%	4,771,825	29.4%
2005	10,372,739	63.6%	5,478,222	33.6%
2006	9,676,398	60.9%	5,690,674	35.8%
2007	9,200,520	59.6%	5,956,353	38.6%
2008	7,247,004	56.1%	5,433,169	42.0%
<b>2009</b>	<b>4,522,904</b>	<b>51.7%</b>	<b>4,159,541</b>	<b>47.6%</b>
<b>Change</b>	<b>-37.6%</b>		<b>-23.4%</b>	



# Where is Canada in this MESS?



# Canadian Automotive Employment 1947-2009



Source: Statistics Canada Survey of Employment, Payrolls, and Hours



## New Capital Expenditures in Canada and the US - \$CDN Millions

### Assembly Sector

	United States	Canada	North America	Canada Percent
2000	\$7,096	\$1,806	\$8,902	20.3%
2001	\$6,884	\$2,338	\$9,221	25.3%
2002	\$7,533	\$2,206	\$9,739	22.6%
2003	\$7,244	\$2,843	\$10,087	28.2%
2004	\$6,100	\$2,260	\$8,360	27.0%
2005	\$4,954	\$2,327	\$7,281	32.0%
2006	\$4,310	\$2,736	\$7,045	38.8%
2007	\$3,742	\$2,846	\$6,589	43.2%
2008	\$4,212	\$2,450	\$6,662	36.8%
2009	\$3,450	\$1,345	\$4,795	28.1%



## New Capital Expenditures in Canada and the US - \$CDN Millions

### Parts Sector

	United States	Canada	North America	Canada Percent
2000	\$13,163	\$905	\$14,068	6.4%
2001	\$12,968	\$683	\$13,651	5.0%
2002	\$11,867	\$1,097	\$12,964	8.5%
2003	\$10,396	\$1,005	\$11,401	8.8%
2004	\$8,146	\$1,008	\$9,155	11.0%
2005	\$8,240	\$820	\$9,060	9.0%
2006	\$8,052	\$864	\$8,916	9.7%
2007	\$7,912	\$1,231	\$9,143	13.5%
2008	\$7,560	\$881	\$8,441	10.4%
2009	\$4,280	\$425	\$4,705	9.0%



What is the role of Government Policy? Can the Gov't play in this sector, if so how, how aggressively, where etc.

# **Need to set the Rules of Engagement for Government Policy**



# Rules of Engagement for Government Policy

- Absolute neutrality between corporate players since nobody can predict who the winners and losers are going to be! Current Governments are violating this rule in a very big way with the 'bail out' of GM and Chrysler.
- A global approach to development since the industry itself is becoming very global ... The 'Bail out' is problematic in that it is North American Centric!
- A focus on promoting efficiency where-ever possible since only the lowest cost jurisdictions will thrive ... there is still opportunity for Governments to play in all of these areas:
  - **Investment promotion to get latest technologies into North America**
  - **Infrastructure development**
  - **Taxation and regulation**
  - **Human Resource Policy**



## Rules of Engagement for Government Policy

- Extreme Caution on approach to social policy agenda items since they are usually extremely expensive to the industry and can divert massive resources away from developing a sound business model.
- No amount of positive industrial policy initiatives are enough to offset even the smallest policy mistake on these social policy agenda items.



## **The Future of the Automotive Sector is the “Six Inches Between our Ears”**

- **Wages and jobs are increasingly being linked to skill/intellectual capability**
- **N.A. Automotive sector annually spends about \$30-35 Billion in Research, Design, Development and Testing of Vehicles and Parts**
- **In essence there are four possible scenarios for the US and Canada**
  - **Low wage – Low skill (currently China, Korea, Mexico ...)**
  - **Low wage – High skill (currently India, possibly Mexico ...)**
  - **High wage – Low skill (Historically in Canada, U.S.)**
  - **High wage – High skill (The Future for Canada, U.S.???)**



# **What Mistakes were Made and what Lessons can an Innovative Farmer learn from the problems in the automotive sector**



## 1. Be careful of the Prevailing view

- Detroit “ didn’t build the cars people wanted to buy” or “the unions destroyed these companies” .. These were factors but they are shallow and unconvincing when examined in detail.
- The reality is that Detroit got caught in outmoded ways of thinking and ways of motivating people which I will review over the next dozen slides. These worked well in the past but times changed and Detroit did not update their beliefs ... you might call it “Management by Mythology



## **2. Never take your eye off your end customer**

- Detroit took their eye off their end customer and lost market share for almost two decades.**
- Lesson: If you lose your customer you are bankrupt ... it doesn't matter whether you are in the automotive sector or any other sector including Agri-food. Adam Smith and his invisible hand is more powerful than any farmer, Government official, marketing board etc.**



### **3. Don't Jilt your hometown honey for the sexy girl next door**

- **Detroit fell in love with the sexy girl next door ... TRUCKS ... and jilted the hometown honey ... CARS ...**
- **When trucks fell out of favour they were so far behind on cars they couldn't catch up**
- **Lesson : Do not pursue a sexy new crop without making sure you have a strong fall-back plan ... at the very least diversify ... some crops may be boring but they are ALWAYS in demand.**



## 4. Product, Product, Product

- Success or failure always comes down to three words, product, product, product. Virtually every time a vehicle company finds itself in trouble it originates in product issues and every company that has recovered from their woes has the roots of their success in product issues ... witness Ford today on the positive and Toyota on the negative.
- Lesson: ... those who focus on product are successful BUT .....



## 5. Homeruns don't trump many singles

- Product wins in true but then Detroit extrapolated that to “exciting product wins”
- NOOOOOOO!!! Boring product wins if that is what people want ( witness Toyota )
- Making many types of really good cars is better than hitting one product out of the ballpark ... the fitter athlete will eventually overcome the one who relies on sheer grit. And this comes down to having control over your PROCESSES since this allowed Detroit's competitors to make cars consistently better
- Lesson: Be the best farmer of anything the world has seen ... don't sweat the guy who leapt into 'organic tacos' but has no control over his processes ... you will win in the end



## 6. Cost doesn't Trump Price

- Detroit took cost of out everything believing taking 4 cents out of a glove box cover would help them sell more cars ... they then put \$4,000 onto the windshield to move the product ... duh!!!
- Detroit never understood what its product sold for instead believing units sales were more important than revenue per sale.
- Lesson: an incremental dollar spent on getting a better price can pay off better than getting your costs down.



## 7. Bigger isn't necessarily better

- GM tried to become bigger by adding brands, entering emerging markets etc. believing unit volume was the only success metric that mattered ..... they shrank in size every year.
- Instead of growing volume they simply added complexity and diverted scarce resources to very small niches in the market diluting their core markets
- Other brands ... Audi, Hyundai, Subaru ... all stuck to their core brand values and all are growing rapidly
- Lesson ... I'd rather have a smaller farm that makes money than a bigger one that doesn't ... you can't lose money on everything you sell and then try to make up for it on volume



## 8. Levering up doesn't necessarily make sense.

- Detroit bought every car company that was for sale believing synergies and lower costs would be automatic
- “Hey lets double capacity from 100K to 200K, just think about how much money we will save with better economies of scale ” ... oops, our supplier's ideal volume was 100K so price per part didn't go down but added complexity and financing the deal added cost... and Detroit ended up worse off NOT better off
- Lesson: When you add those 100 more hectares don't assume everything will scale up fine ... you may be just running your harvester into the ground with extra work.



## 9. Cash is King

- Detroit played to almost all the agenda's put in front of them, be they union demands, Government demands at all levels, employee demands, dealer demands, pension demands, health care demands etc.
- They couldn't say NO to anyone and everytime they said yes it helped deplete their cash reserves
- But when you run out of cash you are bankrupt
- Lesson: Learn to say "NO"



## 10. Debt is the Root of all evil

- As Detroit ran out of cash they borrowed way to much, pure and simple, and when the market collapsed they were unable to pay their creditors
- Lesson: DO NOT LEVER UP A CYCLICAL BUSINESS .... Financial Management 101



## 11. You can run but you can't hide from your problems

- Detroit developed a number of “safety valves” that they used to keep sales higher instead of tackling their core problems ... safety valves include consumer incentives, fleet deals, retail leasing, stretching out product programs, forcing inventory onto their dealers
- All these did was give them a false sense of security and MASK core problems
- Lesson : “When the tide goes out you find out who isn't wearing a bathing suit” ... don't hide from your problems .... Solve your problems



## 12. Be careful what you ask for you might get it

- Detroit lobbied hard to restrict imports or at the very least force import companies to build their vehicles in North America arguing that “if only the import brands faced the same issues we faced, they wouldn’t do as well”
- Well Detroit got their wish and the import nameplates build 28 assembly plants in North America
- This has provided import brands with more capability to take market share rather than restrict their ability to grow
- Lesson : Don’t force your competitors to make decisions that will make them tougher competitors



### **13. Don't forget to take care of the entire value chain**

- **Detroit blamed their dealers and didn't support their distribution system and thus thousands of dealers disappeared over the last two decades**
- **Now these OEMs have little to no distribution in place in some parts of the country to take advantage of current market dynamics.**
- **Ford is the best example, they have cut their dealer body in half over the last two decades but now that they have an opportunity to grow they don't have a dealer body that can maximize their potential**
- **Lesson: Don't forget your distribution channel, if there isn't a road side market to buy your corn you won't sell much corn**



## 14. Invest or Die!

- Those companies that continue to invest in both product programs but also in improving their processes will usually do better than those that don't invest.
- Today GM is better positioned than Chrysler since they kept their Research, Design, Development and Training high during the last decade while Chrysler gutted this capability as a way to maximize profits and may not survive
- Lesson: your farmers NOT sailors ... buy a new piece of machinery instead of that new boat you've had your eye on ... after all you are "INNOVATIOVE" farmers



## 15. Government really isn't your Friend

- Detroit has consistently gone to Government for help (long before the current bail outs)
- But Government help always comes with a quid pro quo ... they scratch your back and the Government wants you to play to their agenda
- But the Government agenda rarely meets the very basic market tests and usually end up diverting scarce resources away from core issues
- Lesson: If you want to be a small farmer ... take your large farm and ask the Government to help you run it



## 16. Be careful of the theory of “unintended consequences”

- For every action there is an equal reaction in the system some of which may be ‘unintended’.
- GM launched their “get America rolling” campaign in response to 9-11 since they feared that 9-11 would kill the market and take away their time to re-structure
- The result was an overheated market for most of the decade and the eventual collapse of the market in 2007 to 2009.
- The collapse caused them more problems than what would have occurred had they had just let the markets work on their own ... and if they had let the market slide they would have been forced to get more serious about their re-structuring sooner
- Lesson: Be careful of knee jerk reactions to issues and think through ALL the potential consequences
- “The inevitable NEVER happens. It is the unexpected always” John Maynard Keynes



## 17. Strategy is important but not as important as execution

- Detroit came to believe that ‘Strategy’ trumped ‘Execution’ ... a brilliant CEO is all we need
- But getting about 3,000 individual parts correct is more of a challenge and more important .... “gas pedals anyone!” ... than the best strategy money can buy.
- Initiatives like Ford 2000, Schrepf’s Global Empire, GM Onstar/Saturn/Hughes/EDS/Fiat/Hummer/Saab etc only drained brain talent from the real task of making great cars.
- Lesson: Getting 1% better every month beats leaping ahead this year and falling on your BUTT next year.



# Questions?

[www.desrosiers.ca](http://www.desrosiers.ca)

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