



Planning in an Age of Uncertainty

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It is beginning to look a lot like 1982. Automotive production levels in North America in 2009 are likely to drop to just over 10 million units. The level of decline is almost identical to the peak to trough decline of 42% experienced between 1978 and 1982. The \$64 question is whether or not things will get any worse before they get better. The biggest challenge facing OEMs and suppliers this year will be the significant variation in quarterly production. The first quarter of 2009, for example, should come in at an unbelievably low 7.5 million units. Little wonder that the industry is struggling to survive at those levels. It should “recover” to approximately 10 million units in the second quarter and could be as high as an 11.5-12 million unit run rate by the 4th quarter of 2009. While still phenomenally low in comparison to the last ten years, anything above 12 million units is a level of survivability for most suppliers and OEMs.

While we believe the 10 million unit production level for 2009 represents a conservative and realistic planning number, no one knows for certain if the economy has hit or is near bottom and how quickly things will begin to recover. We are making an educated guess just like everyone else. It is this uncertainty that has so many industry participants paralyzed at the moment. In a recent conversation with a CEO, for example, his comment was; “I don’t really care if things are going to stabilize, get 20% better or 60% worse. If I knew the level I could plan for the future. Right now I cannot plan anything because I don’t have a clue what is going to happen.”

Since the extreme volatility in the marketplace is likely to remain for at least the next few years, there are several areas that can improve participants’ ability to cope with this perpetual change.

Increasing Manufacturing Flexibility

While there is little companies can do to cope with the huge variation of quarterly production levels in the short term, every supplier and OEM should dedicate themselves to significantly increasing the flexibility and adaptability of their manufacturing processes in the future. If there is one lesson that has come out of this automotive industry collapse, it is that Honda is the only truly progressive car company in the world. They are the only OEM that has production processes that can make changes on the fly and move vehicle production from one plant to another with relative ease. Even Toyota has a lot to learn from Honda. Toyota’s habit of building a new plant around an individual product (e.g. the Tundra) has really come back to bite them during this worldwide downturn. Suppliers need to learn the same lesson. An ability to flex production up and down and change product mix based on market conditions will be a key success factor going forward.

Program Mix

While low levels of production are the most serious short-term issue, knowing what programs will succeed or fail is the biggest industry dilemma over the next few years. There has already been a significant change in program mix over the last 12 months.



Whether this is a permanent shift in vehicle mix or an overreaction to last year's sky high fuel prices is unclear. While everyone appears to be planning on the continued demise of the truck segment in favor of small cars, someone needs to tell the American public. Their buying patterns of the last few months indicate a willingness to continue to purchase traditional truck platforms and small cars are now one of the most difficult vehicles for dealers to sell. There is no question that this phenomenon is primarily because of the huge incentives dealers have on truck products and the continued low levels of fuel prices. But we remain concerned that too many OEMs and suppliers are shifting their emphasis to cars vs. trucks without understanding that the reality in the future may be much more complex.

The various competing demands of increased fuel economy, reduced emissions, and the historic desire of American consumers to have vehicles that fit their specific needs will drive greater program complexity not a "clean" trend towards more cars and less trucks. This will add pressure to provide more vehicle variants that will probably have much shorter lifecycles (e.g. 2-3 years) and significantly reduced annual volumes. Automotive marketing may begin to mimic other consumer segments where the first few months of a new product determines whether the product remains or dies a quick death.

The Way to Cope With Constant Change - Mass Customization

Learning to make money in this new, continuously changing environment will be a challenge for most OEMs and suppliers. Very few have a robust product development process or a business design that can cope with this degree of complexity. The only way to do this effectively is to completely change the way vehicle architecture is approached, something most of the OEMs are doing with various success.

By designing products and vehicles around a common architecture, the ability to adapt a product or technology to a specific vehicle application becomes much more feasible. In our experience, the suppliers furthest along in this approach are ones with a strong competence in electronics where they have had to cope with the extremely short product lifecycles of most electronic products. The only way to keep up with 12-18 month product lifecycles is to approach product design from a more modular vs. one-off approach. As a result, they have had to re-think every aspect of product design including the way the product is manufactured. Flexibility and adaptation become the key enablers to success. Embracing a mass customization approach is the future of the automotive industry and will be a key determinant of which OEMs and suppliers survive in the future. It is the only way to cope with the increasing volatility of the market.