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POINT OF VIEW

DRIVEN BY A NEW COST MINDSET

Automotive and Industrial Equipment players can re-enter growth mode with the Zero-Based approach (ZBx).

CONTENT

RETHINK COST

Like many others, the Automotive and Industrial Equipment industries are facing a global crisis. COVID-19 has triggered a demand-side shock comparable to the years of the financial crisis in 2008 and 2009.

Additional industry challenges await, including climate change and an inevitable shift away from the combustion engine. At the same time, customers are demanding increasingly innovative and customized features and sustainable, green production. In the last few months, the ongoing pandemic has also paralyzed the supply side. Raw materials and critical components became increasingly difficult to source as whole countries went into lockdown and many suppliers had to close their gates.

An unstable supply chain and declining revenues are faced with unwavering fixed costs of the overall organization. Margins of the Automotive and Industrial Equipment sector seem to be shrinking by the hour. At this point, a seemingly inevitable consequence is the start of siloed cost reduction programs, which will, in turn, impact growth and the future viability of many, many companies. All this could lead to one of the biggest crises in history, and at the end of the crisis the world may look very different for the Automotive and Industrial Equipment sector.

Accenture's **Zero-Based approach (ZBx)** provides a way out of the dilemma. It enables the implementation of effective cost reductions, while freeing up capital to stimulate growth. What distinguishes this approach from others?

- **It focuses on growth,** not on eliminating costs.
- **It focuses on costs that are necessary** for a company's strategic goals.
- **It leverages new technologies to drive future-oriented cost projections** (which may be fundamentally different from historical costs).
- **It initiates sustainable re-evaluation and promotes a new cost behavior in the company** (so cost savings can deliver permanent benefit).

Driven by ZBx, companies in the Automotive and Industrial Equipment industries can establish a new, growth-oriented way of thinking about cost. ZBx will help them avoid harsh cost-cutting programs in favor of collaborative cost assessment and well-targeted budget reallocation—not only to overcome the crisis, but to develop sustainable momentum for new growth.

1 GLOBAL SUPPLY CHAINS IN A STATE OF SHOCK

Global supply chains are exposed to unexpected macroeconomic, geopolitical, and environmental shocks. Take for example the trade war between America, China, and Europe, which has increased costs and uncertainty to an unprecedented extent. The global climate is changing at a rate we have not seen since the last ice age, promising more hurricanes and droughts. These disruptions wreaked havoc on manufacturers' supply chains and procurement operations, keeping chief procurement officers (CPOs) awake at night.

Major players within the Automotive and Industrial Equipment sector are already experiencing negative impacts on their financials, which reflects in the declining performance of combined share prices per sub-segment (see Figure 1). Particularly with regards to Germany, the Financial Times recognizes a an unsettling development: "The German industry is hit by the biggest downturn since 2009."[1]

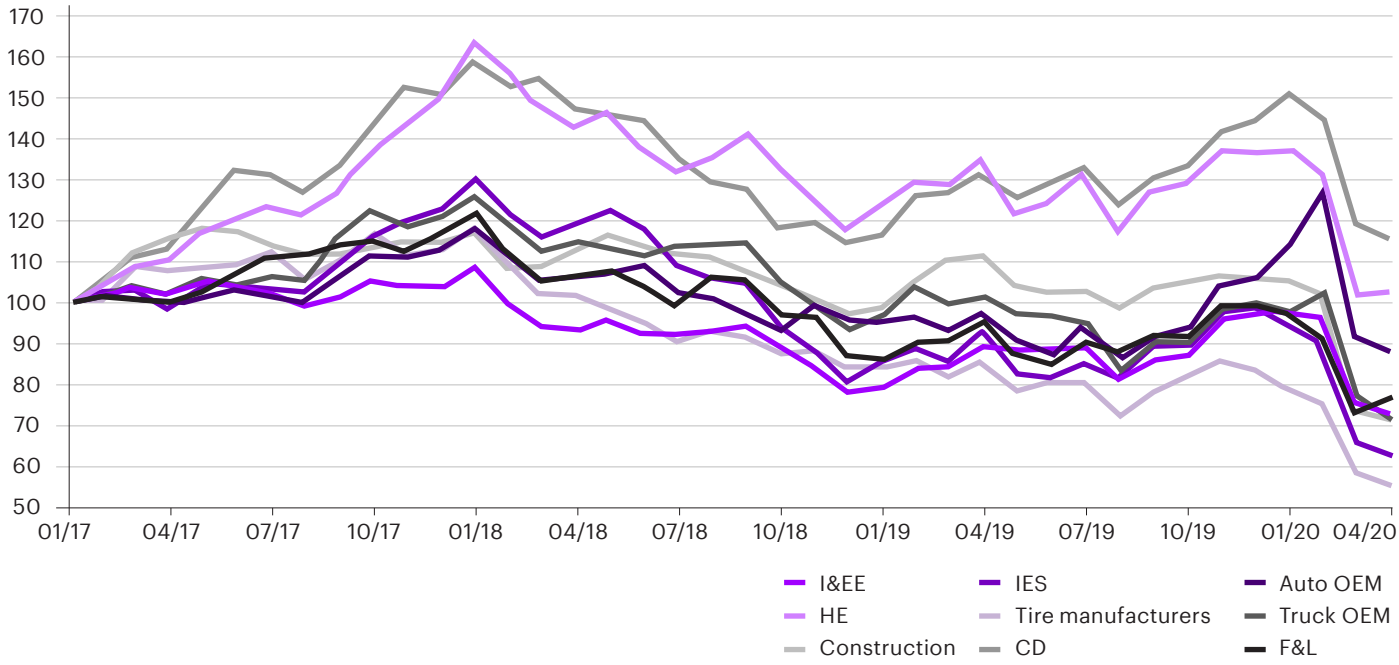


Figure 1: Automotive and Industrial Equipment—revenue growth and EBIT margin[2]

Two dramatic events came together for Automotive and Industrial Equipment:

1. the recent supply chain shocks due to unforeseeable risks such as global epidemics and natural disasters
2. the most significant technological disruption the industry has seen since its inception

This combination of two separate effects caused a state of shock to the Automotive and Industrial Equipment supply chains—specifically to their entire procurement functions, which, in turn, has a sweeping and lasting impact on their overall business performance.

Under these circumstances, a fundamental change in cost thinking can release valuable potential and support new growth. However, many Automotive and Industrial Equipment companies must first make structural adjustments to achieve this. They must decisively improve cooperation and communication between business functions and procurement.

Based on current Accenture Research analyses and experience from client projects, we have identified five principles for introducing **a company-wide, new way of thinking about cost, which we at Accenture call ZBx, a Zero-Based mindset.**

We strongly believe that ZBx can help the Automotive and Industrial Equipment industries re-enter growth mode during the crisis and far beyond.

2 THE FIVE PRINCIPLES OF NEW COST THINKING

Principle 1: Bridge the gap between functional teams

Automotive and Industrial Equipment players must begin to brace themselves against shocks along the entire supply chain. The most common problem Automotive and Industrial Equipment companies face, however, is siloed business units which are too slow in responding to supply challenges in today's fast-paced business landscape.

Consequently, many organizations still lack the necessary transparency or data to quickly counter and mitigate market challenges. Though the use of digital technologies significantly enriches decision-making capabilities in many industries, most Automotive and Industrial Equipment organizations still leverage historic financial (General Ledger), invoice (Account Payable), and purchase data (Purchase Orders) to drive business decisions. Also, the value of procurement analytics remains underestimated in many organizations, and only 62 percent of CPOs have a digital roadmap in place.[3] This is astonishing because ultimately, all purchasing activities are closely linked to the overall performance of the company.

Automotive and Industrial Equipment companies are well advised to increase their visibility by becoming more data-centric across the enterprise. Technologically advanced industries, such as banking or the telecommunications sector, can serve as a model.

How can full cost visibility be achieved in the future?

It can only be reached through closely linked financial and operational data, which is also the starting point for the Zero-Based approach. AI-based analytics solutions can provide detailed visibility on millions of transactional line items. Paired with intelligent benchmarking, this exceeds 95 percent of our clients' expectations in terms of benefits for their supply chain.[4] Most importantly, the "forensic" level of cost transparency helps identify costs that really add business value to future growth versus non-productive spending.

As the example shows, the Automotive and Industrial Equipment sector still struggles to unleash the full potential of its data due to factors such as data heterogeneity, facility decentralization, and incompatible ERP systems. As a result, Automotive and Industrial Equipment companies lack fundamental business insights that would subsequently enable them to unleash sustainable savings and growth potential with the help of forward-looking analyses.

We recommend bridging the gap between functional teams through efficient data collection and use.

1/3 of CPOs have not identified procurement analytics as a priority yet.

A client example

After years of dominance and several international acquisitions, an international transportation manufacturer found itself stuck in a culture of complacency and clumsiness. Lost in an almost inscrutable jungle of ERP systems and procedures, the client lacked the internal communication to thrive in today's agile economy. To continue its successful operations in more than 50 countries, the company needed an international language to bridge these gaps.

Accenture found that the client had failed to reconcile its General Ledger (GL) data with invoice data, resulting in a discrepancy of more than 40 percent. Without reliable data, the company could not accurately determine its spending on any given product, nor could it identify which expense categories were driving the overspend. Appropriate visibility was needed before the team could begin to identify and correct inefficient expenditures.

To accelerate the collection of over one million indirect spend line items in Accounts Payable (AP) across 50 countries, Accenture used an AI tool that categorized existing data, gaining accuracy while progressing through the reams of data. Our mission was completed in a matter of a few weeks.

With the baseline database now in place, the project team was able to drive a 10 percent reduction in the client's indirect spend that hit the bottom-line with immediate effect. In addition, spending patterns are currently being analyzed and, building on this, a predictive analytics solution will be developed.

Principle 2: Create company-wide cost awareness

In many Automotive and Industrial Equipment companies, procurement remains a back-office function and is not consulted in critical business decisions which should be led or enforced by procurement. Examples include introducing enterprise-wide cost cutting programs, gaining control and transparency over the value chain, developing a sustainable sourcing strategy, and creating an agile supply chain.

As a result, procurement spends too much time processing orders and falls behind on value creation. It is not uncommon that procurement and the overall business have conflicting priorities. Reducing spend can be at odds with increasing customer satisfaction, which again tends to take priority over the concerns of procurement.

There is much evidence that a mature and empowered procurement function is good for business. This is most obvious in enterprise-wide cost-reduction programs—as collaboration between business and procurement leads to far superior results. Procurement excels at contracting, sourcing, and negotiating, specifically for non-complex commodities such as marketing, travel, or facilities management, where the broad strategic and analytical skillset of a category manager can take effect.

Technical commodities are usually addressed in a more sophisticated manner due to their complex nature, leaving significant value untapped. For Automotive and Industrial Equipment companies, technical commodities can often represent between 40 and 60 percent of total indirect spend.

We have observed technical commodities in client organizations, where only a third of purchases were put out to tender and less than 60 percent of spend was covered by framework contracts.

In our experience, specification and demand levers for technical goods remain largely untouched. Complex commodities such as machinery components, tools or production machines require profound technical know-how and the skillset of an accomplished strategic category manager to challenge technical specification in production-related commodities. Challenging demand and specification are no longer business partner-only activities—they are a joint responsibility of the business and the procurement function. However, research shows that stakeholder partnering is still one of the weakest capabilities within the Automotive and Industrial Equipment industry, with less than 2.5 points out of 5[5].

So, how can this be changed?

In our Zero-Based approach, we address this challenge by restructuring "category ownership".

Dual ownership of each global category creates healthy tension between business functions and procurement.

It gives procurement the authority to question functional and technical specifications for goods. While senior company executives act as Category Owners, Co-Owners from the procurement department act as their counterparts, holding them accountable. Co-owners share the responsibility of reviewing and challenging both commercial and technical purchase requests, approving award recommendations, and setting and tracking the category budget.

In practice, dual ownership begins with the development of a common category strategy. This then guides the implementation of common organizational goals, such as performance targets linked to functional levels which contribute to the same (cost-reduction) goals. The implementation of the governance framework for cost-reduction programs takes some time. Until category ownership is established, a purchasing committee can be used as an interim solution to empower the organization to challenge technical commodities. These committees act as gatekeepers for purchasing requests above certain thresholds through a dedicated cross-functional team consisting of VP-level stakeholders from finance, procurement, and plant management.

In Automotive and Industrial Equipment, that kind of committee proves highly effective. It can increase the rate of competitive bidding significantly and reduce cost on an average purchase request through specification by 8 to 12 percent.

up to 60 % of indirect spend requires profound technical know-how

Principle 3: Take care of home-made supplier challenges

As in any other industry, Automotive and Industrial Equipment companies source their products and services from a highly dynamic and competitive market. However, often they almost intentionally push themselves into supply markets of monopolists.

Speaking in economic terms, a monopoly can occur based on three parameters:

1. The supplier owns critical resources.
2. The supplier is significantly more efficient than any other player in the market.
3. The supplier has the exclusive right to produce a product or supply a service.

Testing the parameters

Applying these parameters to technical suppliers within the Automotive and Industrial Equipment industry yielded remarkable results:

There are no critical physical resources that justify any kind of monopoly for an Automotive and Industrial Equipment supplier: Many companies can produce Automotive and Industrial Equipment equipment; none of the resources needed are rare. The decisive factor is usually the geographical location. Up to 90 percent of all suppliers tend to be local suppliers. Due to the missing link between procurement and corporate functions, nothing is counteracting this tendency. As a result, many companies limit their portfolio of suitable suppliers to just a few.

When it comes to standard production machinery, tools, equipment or packaging material, the differences between suppliers in terms of efficiency are usually marginal. What distinguishes them is their role in the development of new products. Both production sites and the purchasing department get involved once a new product has been fully developed and designed. However, by then it is too late to plan fully-fledged competitive procurement activities. Since speed to market is often the most important competitive advantage, the time factor restricts the selection of the best supplier, and thus almost inevitably drives up costs. The unrivalled suppliers selected via spot buys are in a comfortable position. They can define the product specification according to their own production facilities and ensure there will be no competition when procurement finally begins to transfer recurring spot buys into framework contracts. Again, we end up in a monopolistic environment.

Exclusive rights to provide a service or product are rarely granted. Nevertheless, many people in the Automotive and Industrial Equipment sector will admit that strong commitments to individual suppliers do often exist. There are three main causes for hidden monopolies:

- OEMs tend to infinitely raise the bar of standards, so that only very few suppliers can meet them.
- New ideas are often already developed together with a trusted local “supply hero”.
- Internal KPIs for OEM managers do not include targets for supplier prices.

Whichever applies: the list of potential suppliers remains or becomes very short.

This situation is often fueled by the KPIs of the business function which are measured in terms of quality, transport safety and process speed. And of course, it tries to exceed these parameters. Savings, on the other hand, are not a priority. At least not until now.

A client example

One of the globally leading premium automotive OEMs experienced a typical case of over-specification of packaging material. Due to a lack of planning capabilities, new products were being introduced without considering their actual packaging needs. Business had to act fast and co-create new packaging material with a "local supplier" via spot buys. Consequently, the design fit perfectly to this supplier's specific production facility. So, even when the spot buys were transferred to a framework agreement, no competitor was interested in this volume anymore.

See the problem?

Then it is time to come up with a solution based on the Zero-Based approach. Nobody can afford self-inflicted supplier monopolies these days.

It is the duty of all business functions, including procurement, to jointly take care of homemade supplier challenges.

The solution is twofold. On the one hand, strong governance is required to ensure continuous exchange between business, procurement, and finance. This extends all the way from budgeting to new product development and the purchasing process (see also "category ownership" as introduced in Principle 2).

On the other hand, it requires an overarching cost consciousness. The entire organization needs to change its way of thinking about cost. Engineering, the business functions, procurement, finance, and sales must adopt a Zero-Based mindset. It takes an almost clinical look at the entire spend across an enterprise.

This is called "Value Targeting". We use benchmarks to identify where companies are overspending — comparing results with competitors — while also addressing where financial resources could be better spent on new growth initiatives.

Supplementary to classic benchmarking exercises, mature organizations use reference price calculations and cost modelling for larger purchases in the project environment (especially for CAPEX projects). That said, our ZBx approach is based on this fundamental perspective — **namely what a company's costs should be in terms of its strategy and ambitions.** ZBx leverages new technologies to drive future-oriented should costs, which are fundamentally different from historical costs.

With strong governance and enterprise-wide, holistic cost awareness, companies can take full advantage of opportunities in their diverse, existing supplier market and open themselves to new markets and suppliers.

Up to 90 % of the supply base is local.

Principle 4: Ensure cost savings reach the bottom line

At the end of 2019, the CEO of a leading multi-billion-dollar automotive manufacturer announced a cost-reduction program: The corporation plans to reduce the cost of materials, limit investments, and streamline the vehicle range. Thus, the company aims to achieve a higher profit margin and save more than 1.4 billion euros in personnel costs. Worldwide, this means a reduction of up to 15,000 jobs.

News like this illustrate that C-Suite executives in Automotive and Industrial Equipment see cost reductions as a key lever for future growth. However, in corporate practice, there is often a difference between planned or actual savings in procurement and actual P&L-relevant savings.

What causes this gap? And how can it be reduced or closed with the ZBx approach?

If savings targets are not deducted from the budget, the available budget remains the same — and budget volume released can easily be (re-)used for other purposes or projects. And these are not isolated cases. We often find that in leading companies traditional budgeting does not reflect changes in business.

In our Zero-Based approach, we achieve this by "locking targets into budget" ("Zero-Based Budgeting").

This ensures that the objectives of new cost-reduction and revenue-optimization initiatives are incorporated into the budgeting process and reflected in the approved budgets for the company's business functions. Combined with dual category ownership, the Zero-Based Budgeting approach also prevents leakage and unapproved shifting of budget by individual business owners.

Accenture helped this client reset its budget from a zero-base while embedding all savings initiatives in the revised budget. Within a few weeks, the multinational enterprise felt the savings positively impacting the bottom-line P&L.

50% of procurement savings failed to materialize.

A client example

A global rail transportation OEM with its main production facilities in Europe and North America recently underwent an extensive austerity program. But despite a strong governance over monitoring savings and sponsorship from senior company executives, it failed to see the full impact in the P&L.

There were two reasons for this:

1. Identified savings were not embedded in the budget. While the controller team was tracking savings against a defined savings target, the production sites did not see any adjustments of their budget. There also was no consequence management in place when they would spend their entire budget at the end of the year. The bottom line was that almost 50 percent of the costs were not reflected in P&L. As a result, close to 50 percent of the savings reported in the governance board did not deliver an impact on the P&L; they simply remained theoretical savings.

2. At the early stages of the program, there was no aligned savings definition within the finance function. As a result, the teams started working on initiatives that were measured by the finance department as cost avoidance, and therefore were not accounted as P&L savings. So, resources were focusing on the wrong initiatives.

Principle 5: Transform cost cutting

Applying all the previously mentioned initiatives with a top-down cost-reduction mindset inevitably leads to failure—and here is why.

Traditional cost-reduction efforts have never really worked in the long run. Costs have often been shifted from one area to another at the expense of another—only to eventually return to where they came from.

In fact, only 36 percent of the companies surveyed believe that their company will benefit from cost-optimization programs in the long run.[6]

We observed a global transportation client requiring intensive blue-collar labor that froze the hiring of internal manufacturing staff to reduce costs, only to see contractor spend on manufacturing rocketing. This is just one example of an unstructured and siloed cost-cutting approach negatively reverting.

But—astonishing as it may sound—there is a simple explanation for all of this: Most cost-cutting measures only aim at managing a specific event or achieving certain results—for example, eliminating a percentage of costs. However, to achieve long-term benefits, fundamental changes in cost thinking and behavior are needed.

How can cost cutting transform into a structured, cross-functional power accepted by all areas of business?

The Zero-Based approach also provides guidance for this. Making cost reductions permanent and future-proof requires a **cultural transformation.** The way an organization thinks and behaves must change fundamentally. Making sustainable cost reductions requires a commitment from the CEO and the leadership team to continuously operate on a zero base. It is also important to communicate the benefits of long-term change to customers, employees, and other external stakeholders. That is why our approach includes a strong focus on embedding changes into an organization's DNA. We aim to make people more cost conscious, change how they think and work, and make them understand the correlation between costs and business growth.

One way to look at it is to create a healthy tension within the business, as described above with the **category ownership** concept. This tension between the business function as budget spenders and category owners from procurement will drive a more appropriate behavior. It will foster a cost-conscious mentality and reduce the probability that budget spenders will return to their old ways of thinking and working.

Closely tied with category ownership, as the sixth step in the ZBx loop, Accenture recommends implementing a monthly routine called "control and monitoring".

Cost category owners and budget holders jointly observe the deviation of the planned budget from the actual values. This helps your organization change behavior and make quick decisions on budget usage when variances occur and immediate corrections appear necessary.

A client example

A global multinational transport company wanted to ensure that its budget would be achieved at the end of the year without any deviations. After checking the monthly actual values of the budget, it responded by taking immediate action that directly affected the result (see Figure 2).

If the monthly actuals for maintenance, repair, and overhaul (MRO) spend were, for example, $3 million below budget once, the remaining budget would be allocated to a reserve fund. In that case it would be up to the governance board to decide whether the reserve fund should be used to release budget for the blue-collar category that was over budget due to increased production demand. While maintaining the original overall budget, the company was able to cover unplanned needs without additional funds.

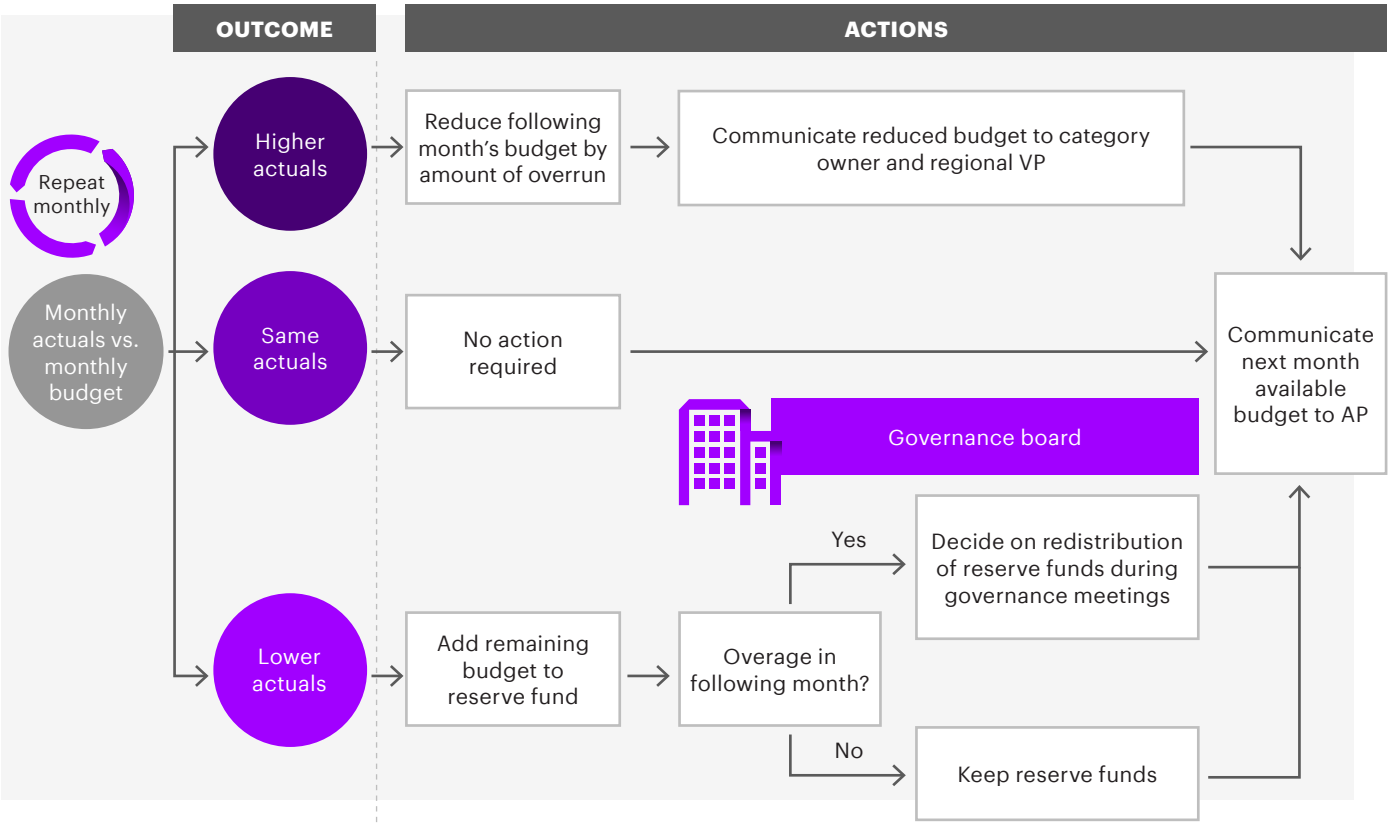


Figure 2: Control and monitoring—monthly actuals vs. budget action plan

3 DIGGING DEEPER INTO ZBX

How do the principles we have just learned ideally work together? Let us dig deeper into the Zero-Based Loop and understand how the new cost thinking will thrive in your organization. Accenture's Zero-Based approach7 is divided into six basic elements which will ideally flow into a closed loop process as quickly as possible — developing lasting cost advantages quickly and providing maximum growth impetus amid the crisis.

1 Visibility. Key element of ZBx is the creation of full P&L transparency through financial and operational data analysis to know precisely "who-spends-how-much-on-what'. That means we segment the cost base using standardized and unique definitions based on the nature of the spend and harmonize the general ledger codes.

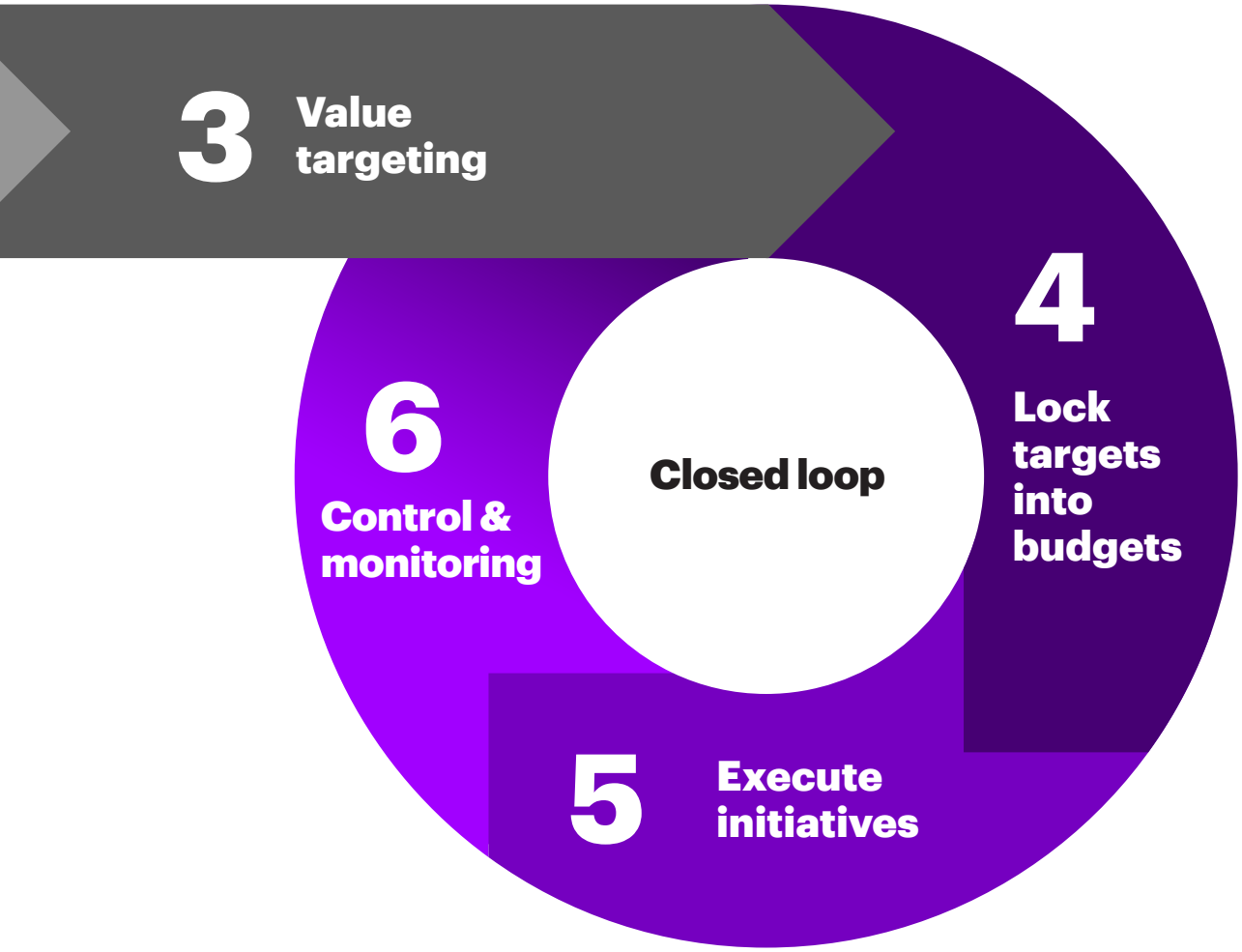
2 Category ownership. Through category ownership we build a strong cost governance with a shared responsibility of every expense between functions and the category owners.

3 Value targeting. Based on the high spend visibility, an organization can create realistic value targets through internal and external benchmarking. To realize those targets detailed cost reduction measures can be defined based on price, specifications and demand levers.

4 Lock targets into budget. Agreed cost reduction and revenue optimizations need to be reflected in the company's budget and owned by dedicated people. Ideally this leads an organization to budget from zero annually to expose and eliminate unproductive expenses.

5 Execute initiatives. Reaping the benefits of P&L savings opportunities means to execute on previously identified initiatives. These can include an array of measures such as strategic sourcing events and buying operations to realize price and demand reductions with suppliers.

6 Control & monitoring. To ensure the sustainable P&L impact and potential reallocation of savings into future growth themes a detailed control & monitoring process will be implemented.


3
Value targeting
4
Lock targets into budgets
5
Execute initiatives
6
Control & monitoring
Closed loop

4 FUND FUTURE SUCCESS

Major Automotive and Industrial Equipment players have been affected heavily by the pandemic, as well as by global economical, geopolitical, and environmental developments. Intensified by the fundamental technological change from the combustion engine to e-mobility, the consequences for profitability and growth are already being felt. The road back to sustainable and stable growth seems rocky, but there's no need to panic. With the right strategy and a new way of thinking cost, the current situation can act as an accelerator to transform your organization and unlock the required capital.

Our Zero-based approach enables organizations to identify discretionary consumption of non-labor related expenses through forensic cost visibility and governance. This allows the C-level to make data driven decisions in order to change the culture of the organization and ultimately freeing up cash that can funnel into growth initiatives, capability improvements and improving EBIDTA.

Moving into action, there are three essential steps to transform your organization's cost mindset:

1 Create Visibility

- Refine your taxonomy to achieve the right level of granularity in your financial accounts. This creates a powerful tool to manage and control costs and ultimately your organization's spending behavior
- Bring together costs from the entire organization in order to reallocate it into the new taxonomy – leveraged by AI analytics. Typically spend baselines tend to increase by up to 40% once all cost has been captured (Source: Accenture 2015; Is ZBB your next engine for growth)
- Start rethinking your budgeting process (even from zero) to remove unproductive costs each year and allow for detailed category strategy planning

2 Establish Accountability

- Refine category strategies to enable smart consumption policies, define control & monitoring mechanisms. Create a positive tension between finance, procurement and the business function
- Establish a strong category governance and ownership in your organization to enable cost management as a continuous process
- Ensure contribution from the lowest level of your organization right-up to the C-level by altering the overall cost-mindset

3 Enable Organizational Change

- Lead by example from the top. The required cultural and behavioral transformation will require powerful change management
- Track and incentivize sustainable results. On one hand ZBx will set the framework and on the other hand employees will need the freedom to act quick, have space to innovate and be rewarded for success

Following those vital next steps, ZBx assists with driving growth when reallocating realized savings into future growth projects. We at Accenture, are ready to embark with you on this journey to position you for future success.

SOURCES

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7 *Accenture's proprietary closed loop process, specifically its methodology and analytical models which are supported by Artificial Intelligence, are patented in the U.S. as of November 14, 2017—Patent number: 9,818,067 B2

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