Winning Strategies

By

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During an economic crisis, it is easy to see the point at which companies face a vicious circle. Companies encounter weak revenues growth, reductions of margins or even losses, and reductions of investments. Which in turn emphasises weak revenue growth… and so on. In the end, there is no value creation, either for the shareholders or for the associates.

However, even during times of economic crisis and even in industries that are reputed to be ‘difficult’, some companies manage to create value significantly.

Let us take an example. The automotive industry.

In Europe, this industry is symbolic of the economic crisis. The market has fallen from 16 million vehicles to 12 million vehicles per year between 2007 and 2013. The large majority of plants (60 % on average) are today over capacity, which has led car manufacturers to close production plants one after the other (PSA in France, Opel in Germany, Ford in Belgium and the UK).

Over the last 10 years, the value creation for most generalist car manufacturers has been disappointing. Not only in Europe, but also in other mature markets like the USA and Japan. Indeed, Renault’s annual TSR[1] has been 5% per year on average between 2003 and 2013, Ford’s annual TSR has been 6% and Toyota’s has been 9%. All of which has been at a level below or just equal to the cost of capital.

Nevertheless, in this same automotive industry, there are some companies that have created value significantly over the last 10 years (cf. Table 1). These companies include Volkswagen (TSR of 24% per year between 2003 and 2013), Hyundai Motor (TSR of 22% per year), and Dongfeng Motor (TSR of 27% per year).

How do they achieve this? They follow winning strategies.

1. Investing in strong growth segments

There is still growth in the automotive industry. No longer in Europe, the USA or Japan. But definitely in China, which is the only large territory that has a long-term trend of strong growth.

Dongfeng Motor is an obvious illustration. The company only has to be among the leading Chinese car manufacturers, along with SAIC and FAW, to grow fast and profitably. And hence to create value (TSR has been 27% per year on average for the period 2003-2013).

Volkswagen is another example that is even more interesting. The company is historically and fundamentally European. Yet, it has heavily invested in China and the emerging countries over the last decade in order to accelerate the growth of its activities in these markets (cf. Table 2).

In fact today, Volkswagen is the leading European car manufacturer in China. The Volkswagen Group has established some joint ventures with the leading Chinese car

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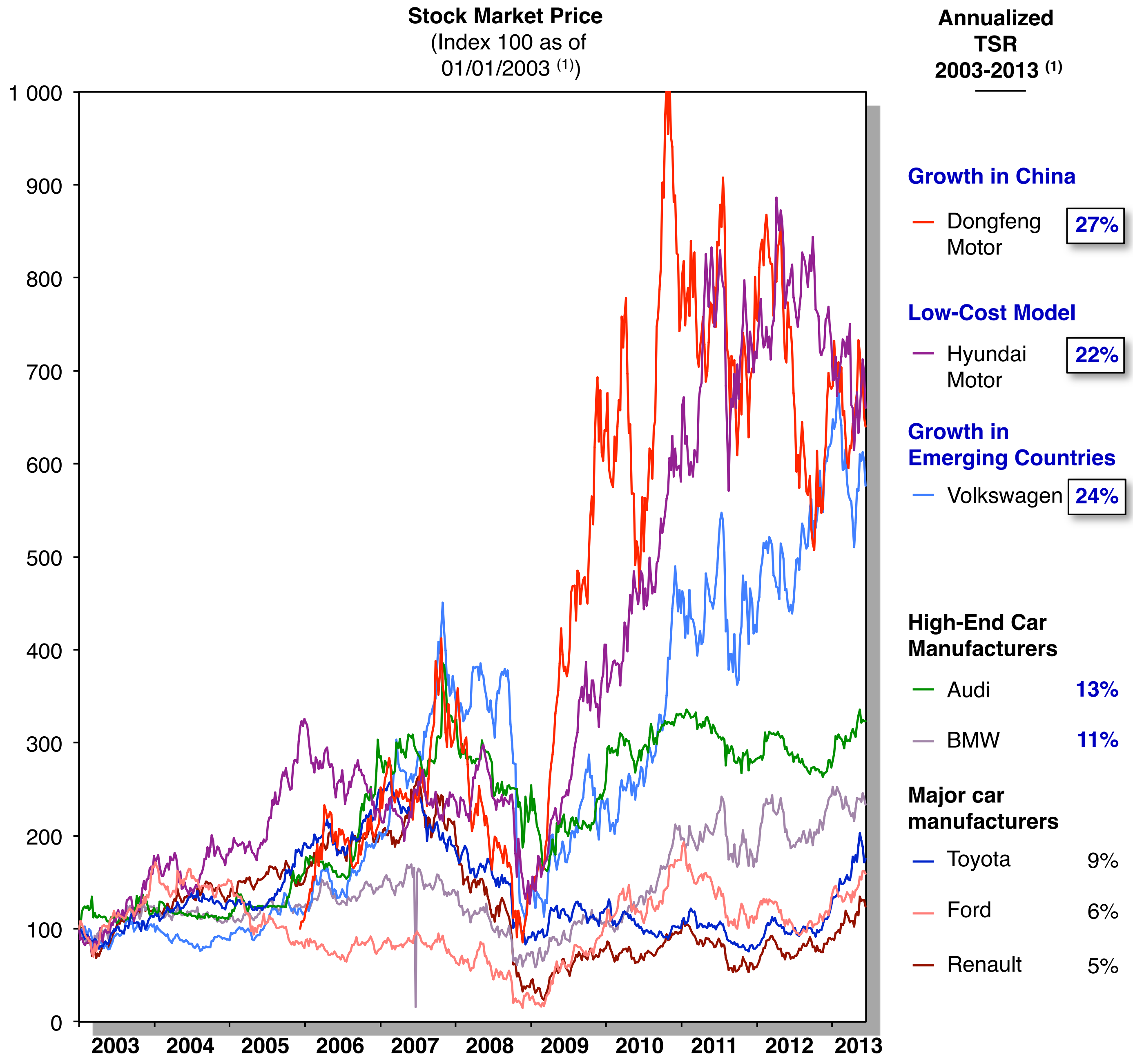
[1] Total Shareholder Return (profits or losses in capital, dividends, bonus shares), with the hypothesis of reinvested dividends.

- Table 1 -

The levers of value creation in the car industry are the growth in China and the polarisation of business plans

(Value on stock exchange of a sample of world car manufacturers, 2003-2013)



TSR : Total Shareholder Return (profits or losses in capital, dividends, bonus shares), on the hypothesis that the dividends are reinvested into the company; (1) Starting from 1st January 2003, except for Dongfeng Motor (starting 9 Decembrer 2005)
Sources: Bloomberg, Estin & Co's analyses and estimates

manufacturers like SAIC and FAW. Overall, Volkswagen sales in China are equivalent to its sales in Western Europe (in volume).

The result has been an average TSR of 24% per year for the period 2003-2013.

By the way, let us note that Volkswagen's strategy of strong investments and growth in emerging countries in the automotive core market has proved to create more value than a strategy focused on the high-end range in Europe. Indeed, BMW and Audi's value creation (with respective average TSR of 11% per year and 13% per year for the period 2003-2013) is approximately half of Volkswagen's value creation.

The polarisation of the mature markets (development of the high-end and the entry-level markets, to the detriment of the core market) generates less growth than the massive development of the core market in emerging countries.

2. Changing to more competitive Business Models

There are other players in the automotive industry who have generated strong value creation over the last 10 years, and most notably over the last economic crisis in 2008-2009. An example of this is Hyundai Motor.

Hyundai Motor's strategy is to choose a business model in order to manufacture at a lower cost, be more competitively priced, and gain market shares in mature markets that are becoming stagnant.

In a way, Hyundai is to Renault and PSA in the automotive industry, what Ryanair or Easyjet are to Air France in the airline industry.

In the European automotive industry, Hyundai Motor has based its costs competitiveness on various factors.

First, manufacturing is now mainly carried out in Eastern Europe (Czech Republic) where the labour cost is 33% lower compared to that of Renault and PSA in France.

Second, the level of automation is pushed to the limit (85% of tasks are automated). As a result, an employee's productivity is around twice as much as a Renault employee (on average in 2012, 86 vehicles were assembled by each employee at Hyundai Motor's factory at Nosovic in Czech Republic, compared to 46 in the Renault's factory at Flins, in France).

Finally, design and organisation are studied in order to reduce costs as much as possible. The manufacturing of entire modules of components (rather than isolated components) is outsourced to suppliers in order to speed up assembly. Manufacturing sites and suppliers' factories are adjacent in order to save further manufacturing time.

As a result, Hyundai's TSR has been 22% per year for the period 2003-2013.

3. Moving to more attractive industries

When the above-mentioned strategies are not possible, there are still alternative strategies. One is to explore new businesses, whether connected or not to the current businesses, which could turn out to be more attractive.

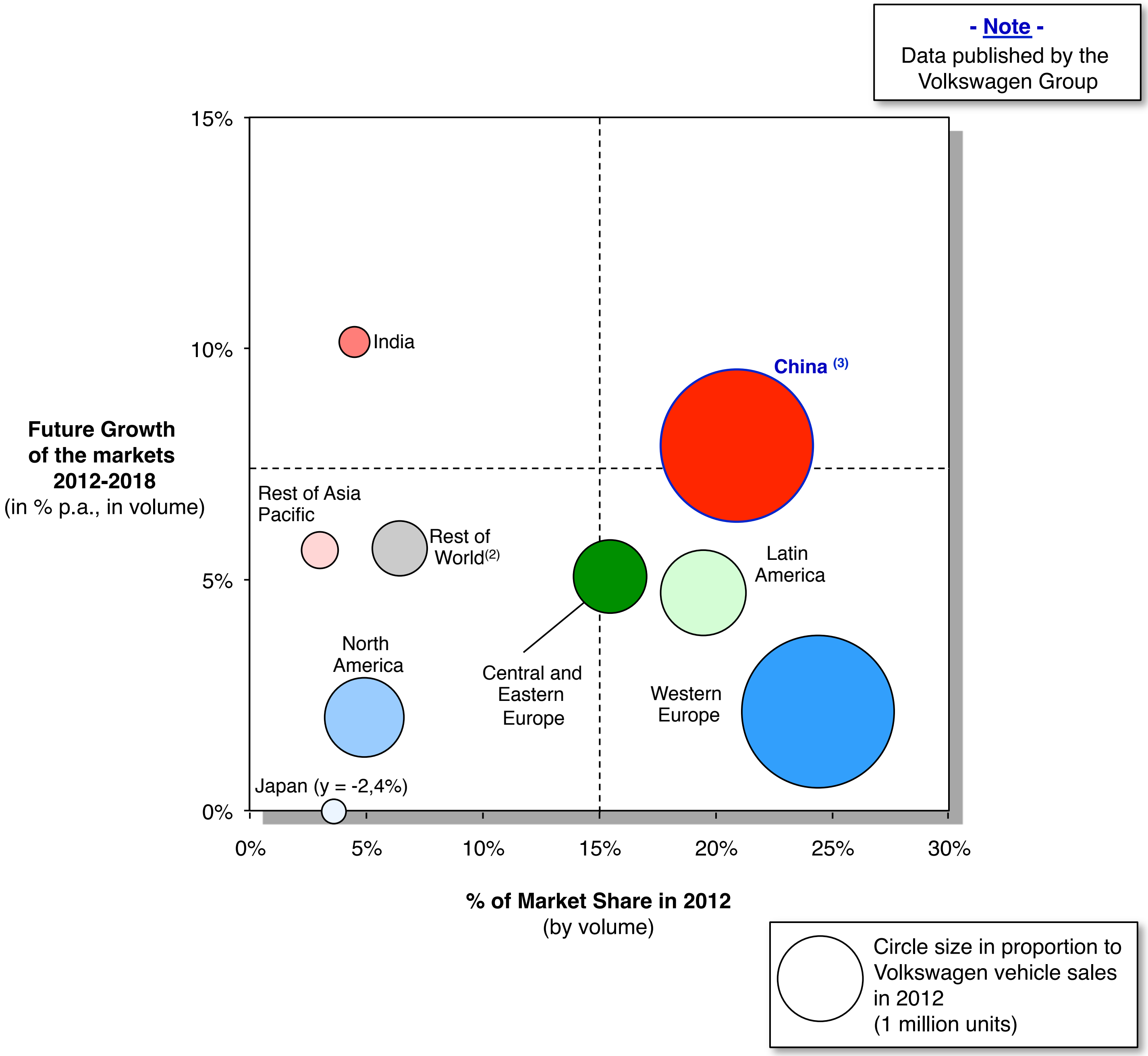
No business can sustain strong value creation forever. The challenge is to change from one business to another with the right timing in order to 'ride' successive value creation waves.

In the automotive industry, some companies are actually doing this. For example, BYD in China has a large proportion of its activity in the production of rechargeable batteries and electronic equipment. Which is a way of anticipating a potential new wave regarding rechargeable electric vehicles.

Outside of the automotive industry, IBM remains an emblematic example. Once a leader in IT hardware, the company deserted this area to refocus and become a leader in IT services. Or Bourbon, who was a sugar producer on Reunion Island in the 1980s, and has today become one of the leaders in marine services related to offshore oil rigs.

- Table 2 -

Volkswagen's sales in volume in China
are equal to its sales in Western Europe
(Volkswagen's portfolio of activities, light vehicles(1), 2012)



(1) Passenger cars and small vans; (2) Africa, Middle East, Turkey, … ; (3) Presence via FAW-Volkswagen (JV with FAW, 588 000 vehicles Volkswagen and Audi products in 2012) and Shanghai-Volkswagen (JV is SAIC, 609 000 vehicles Volkswagen and Skoda produits in 2012)
Sources: Volkswagen (annual reports, presentations to financial analysts), IHS (Information Handling Services), Estin & Co's analyses and estimates

Conclusion

During an economic crisis, the context is the same for every company. The essential point is to perform better than the competitors, and there is rarely a shortage of levers to achieve this. Beyond the illustrative examples mentioned above, there are - by definition - winning strategies in every industry. The key is to identify them, and to follow them through.

What are the winning strategies in your industry?

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Estin & Co is an international strategy consulting firm based in Paris, London, Zurich and Shanghai. The company assists CEOs and senior executives of European, North American and Asian corporations in the formulation and implementation of growth strategies, as well as private equity firms in the analysis and valuation of their investments.