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How Chrysler will cut costs

By -- 2/8/2001

Value analysis is being rejuvenated by the purchasing organization at Chrysler Group as the North American subsidiary of DaimlerChrysler AG tries to regain its financial footing.

"Value engineering and value analysis are back in vogue," says Tom Sidlik, Chrysler's executive vice president of procurement and supply. "We're dusting off the cobwebs and doing value engineering again, and we're going to do this process redesign on a 'big time' basis.

In an interview with PURCHASING Magazine editors, the supply management czar for the company's Chrysler, Plymouth, Jeep and Dodge operations says that "we've accelerated our ongoing cost-reduction programs so that we can take 15% of costs out of the system by the end of 2002."

In Chrysler's two-step program, suppliers have been directed to reduce by 5% the prices charged in 2001 for materials and services and to work with purchasing teams to eliminate another 10% in costs in 2001-2002. "This is a major cornerstone of the turnaround," according to Chrysler's chief operating officer, Wolfgang Bernhard. "We need results fast."

There is a sense of urgency at Chrysler since the automaker has lost North American market share in recent years and seen its operating profits turn into losses. "We are in a difficult business situation," admits Dieter Zetsche, president and CEO of Chrysler Group, talking to editors at the recent North American International Auto Show in Detroit. "We'll do everything necessary to get our costs to where they have to be." He points out that "there have been no price increases on North American motor vehicle sales for a number of years. So, to help improve margins, we have to take costs out every year."

The new Chrysler Group president says the Auburn Hills, Mich.-based automaker will restructure in six cost and revenue areas "to become known again as a lean, mean company, a dolphin among whales and sharks."

Chrysler lost \$512 million in the third quarter of last year and then lost \$1.25 billion in the fourth quarter amid a sudden sales downturn in the U.S. car market-and faces a difficult 2001 as well. The automaker was hurt badly last year when it replaced its minivan line and had to offer high incentives to clear big supplies of old models. Now, with North American automotive sales projected to decline in 2001, the company is scaling back output. Zetsche projects that Chrysler will produce about 2.6 million units this year, down 13% from last year.

Since he took charge in November (replacing James Holden as Chrysler group's chief executive), Zetsche has concentrated on efforts to reduce bloated vehicle inventories. Analysts expect him to oversee more drastic projects, including plant closures and layoffs. In fact, he admits the company is organizing a top-to-bottom cost-reduction and profit-improvement turnaround plan that will be announced by the end of February. "Everything we do is under review to be cut back," according to Zetsche.

And the first cutbacks to be announced have been in the prices paid to materials and parts suppliers by the supply chain management organization supervised by Sidlik. A 20-year Chrysler employee, Sidlik has been the company's chief buyer since late in 1998. In this position, he is responsible for the Chrysler, Plymouth, Jeep and Dodge procurement and supply activities, which include supplier commodity sourcing and strategy, supplier quality, international procurement, platform management, production control and logistics. He also is general manager of Jeep operations.

Sidlik says the purchasing and supply organization's cost-reduction effort is just the first of several similar programs that will be announced by the company's manufacturing, product development, marketing and sales organizations. "Procurement and supply were the first out of the box because materials and supply account for 78% of our total costs," he explains.

Chrysler's North American operations spend about \$40 billion annually with about 900 direct suppliers, so a 15% cost-reduction effort would equal \$6 billion. However, it may be larger than that. Zetsche explains the restructuring will focus not only on material, but also plant and fixed costs, revenue management and product strategy.

For several years, Chrysler has had a series of Supplier Cost Reduction Effort (SCORE) programs. These have encouraged suppliers to find cost efficiencies, who have shared some of Chrysler's savings. Under SCORE , Chrysler in past years has asked suppliers for annual price reductions of 3%; in fact, year-2000 savings were 3.2%. Original plans had been to ask for 4% reductions in 2001 and 3% cutbacks in both 2002 and 2003-a total of 10% from 2000 cost levels.

"Instead of using this incremental approach, the new initiative is asking for a 5% reduction in prices for 2001 and to keep those prices in place through 2003," Sidlik explains. While the price cuts were effective in January, some of them really won't go into effect until annual contracts are renewed.

The additional 10% in cost savings through 2002 are expected to come from Chrysler's Extended Enterprise program. "In this program, we cooperate with the suppliers from the design stage through the manufacturing and delivery of vehicles and find ways to reduce costs; and, believe me, there are lots of places where costs can be reduced," Sidlik says.

The purchasing teams are involved in these value analysis initiatives as procurement and supply personnel working with engineers, platform teams and manufacturing managers-plus the 150 key suppliers who represent 75% of annual materials purchases-to identify the areas for cost



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improvements. (The platform teams are the company's large car, small truck, minivan and Jeep production centers.)

Sidlik says these efforts "are intended to be margin-neutral for the supplier base." None of this really is new, Sidlik says, since similar efforts in the early 1980s and early 1990s "relied on the ideas and innovations of our suppliers to make Chrysler one of the most efficient motor vehicle producers." "Now, in the current business situation, we are counting on our supplier partners to stand with our company in regaining this position in these difficult times." He says the value-analysis programs "will tap into our suppliers' creativity and core competencies across all aspects of our business, in order to ensure Chrysler's long-term viability."

Sidlik explains that the "cost-reduction initiative is designed to have our suppliers help us achieve the optimum lowest per-vehicle cost by keying on content through the use of technology, common parts and, if necessary, redesign across all our platforms."

Richard Schaum, executive vice president of product development and quality, emphasizes that the value engineering efforts will be fast-paced and structured so that multiple teams of Chrysler specialists will spend six to eight weeks over the course of this year with key suppliers to find the best ways to improve material costs without sacrificing quality.

"The pace of change in our industry is extraordinary, and it's never been more important to work closely with our suppliers from product creation to volume production to the showroom," says Schaum, who is also general manager of all passenger car operations.

Although there has been some supply-base grouching about Chrysler's accelerated cost-reduction efforts, Sidlik says much of that has come from a misunderstanding of the overall cost-reduction effort and a fixation on the 5% price-cutting initiative.

He insists that the automaker anticipates a continuation of solid supplier relations. "Of course, reactions to our cost-reduction initiatives vary, but most of them want to stay on as Chrysler suppliers, because they understand our need to reduce costs in this competitive automotive marketplace and see how their cooperation is a vital part of the overall cost-reduction effort." He insists that "the response from the supply base actually has been better than expected," and attributes that to the company's full disclosure about its financial plight.

Another cost-saving initiative for Chrysler will come later this year when the Covisint electronic-procurement exchange (co-owned by DaimlerChrysler, General Motors Corp. and Ford Motor Co.) goes into fuller operation. "Eventually, everything we buy will be done electronically through Covisint," Sidlik says, "and that will save us a lot of money." In fact, Chrysler already has been experimenting with online bidding to lower procurement costs and improve supply chain management. The company has held 33 online auctions for more than 500 types of parts for both production and non-production use over the past several months. The firm has seen a savings of at least 17% overall for those parts in the last 27 of those auctions. In six earlier pilot tests of the bidding process, material cost savings ran about 9%.

Some suppliers rankled by Chrysler plan

Some suppliers are demanding that Chrysler Group reconsider its recent cost-cutting measures. "It's hard to negotiate with someone who tells you they are going to do what they have to do because they have to," says Neil De Koker, managing director of the Original Equipment Suppliers Association.

Chrysler's initiative is to reduce material prices by 5% this year and have suppliers help the automaker reduce costs by another 10% during the next two years. Some suppliers appear willing to work with Chrysler. "We're aware of the request and we'll evaluate it and discuss it with them," says a spokesman for Delphi Automotive Systems, which makes some chassis components, steering and interior products for the automaker. The spokesman says Delphi will work with Chrysler to achieve savings in such a way that "ensures the success of both companies."

However, some other suppliers consider the initiatives nothing less than an act of war. They say their cost margins are squeezed as it is, and that the demands are unrealistic. Some are outwardly saying they will not agree to the initiatives. Many have joined with the Original Equipment Suppliers Association, signing a written statement that they do not agree with the changes and will not accept the terms. But the statement contains the caveat that as long as the two sides are discussing the initiatives, they won't stop shipments of supplies to Chrysler.

De Koker says the automaker is clearly throwing down a gauntlet here. And he believes the initiatives will go a long way toward souring the already strained relationship between suppliers and automakers. De Koker says the new initiatives are being described as a kind of backlash to suppliers who failed to meet Chrysler's SCORE targets. And if this is the case, he says the automaker is punishing many suppliers for the actions of a few. "It's unfair of them to criticize us if certain companies haven't met their SCORE target," he says.

De Koker further calls the initiatives a "desperate" act to get the once-profitable unit out of the red. Jeff Wincel, vice president of corporate procurement and materials for supplier Donnelly Corp., says Chrysler is asking an awful lot from suppliers. "They are trying to piggyback off of the backs of the suppliers," Wincel says.

Wincel says the initiatives are particularly unfair when one looks at the way profits have gone up for automakers, while going down for suppliers. And he says there is nothing collaborative or congenial in the way Chrysler is hammering suppliers with these initiatives now. "In the past, they would say, 'Let's work cooperatively.' Now they are completely gone," Wincel says

De Koker also insists that Chrysler is making a lot of its own problems. He says the automaker has not taken many of the natural steps other automakers have taken to reduce costs in recent years. The company hasn't, he argues, focused on switching to modular systems that would reduce assembly costs. De Koker says Chrysler is comparing itself to other automakers that have taken such steps and managed to reduce costs. He says it is therefore unfair to extract a pound of flesh from suppliers.

"The way they have designed their vehicles, they have not made the same kinds of changes to reduce costs of assembly," De Koker says. "So it's not fair to make a comparison when they are not taking the latest ideas in the world." Even more worrisome, De Koker says, is the feared "most favored nation" impact from such initiatives. The association and its members rightly worry that other automakers will not simply sit by and watch their suppliers subsidize the growing losses for Chrysler and not give them a piece of the action. The association fears other automakers will follow suit with the same or similar initiatives.

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