

# Operational Excellence as No-Regret-Move

## How Automotive Captives Increase Their Success

Automotive captives have been an ascending industry during the last few decades. However, shrinking markets for the automotive leasing and loan business as well as increasing competition cloud the success story. Therefore, the time to act is now. Operational excellence (OPEX) helps captives transforming current operating models in order to remain competitive. The authors outline the main goals of OPEX and introduce the different phases captives have to pass through in order to stay successful. (Ed.)

Automotive captives can look back on a long and successful track record. Over the last few decades, they have seen their revenues and profits steadily increase and a solid business model based on sales support for their original equipment manufacturers (OEMs) has evolved. Despite challenges on the OEM side, ranging from stagnating car sales in established markets to emission scandals and fleet electrification, captives still remain very strong profit contributors. They generate up to 55 percent<sup>1)</sup> of profits (calculated before income and taxes) compared to overall group results and hold

up to 69 percent of the group's assets<sup>2)</sup>.

### Market Trends

Despite continuously increasing revenues in the past decade, the cost-income-ratio (CIR) remained relatively stable or even increased among most captives, for example Volkswagen Financial Services with a CIR of 57 percent in 2020 opposed to 54 percent in 2019<sup>3)</sup>. Reasons for this trend may include increased labor costs in the largest sales markets, widely manual

processes, outdated legacy IT systems and complex product portfolios. In their historic role as sales support for OEMs, captives had a more sales-driven mindset and barely focused on costs and processes.

Even though captives have not been as strongly affected by current market trends as most of their parent OEMs in recent years, the outlook is not necessarily positive for the vehicle leasing and loan business in various markets. A closer look at the revenue side reveals that the majority of revenues in the captive industry at present (both leasing and loan business) are directly in line with global automotive vehicle sales. No one can precisely predict the exact impact of the current Covid-19 crisis at this time, but by referring to Deloitte's pre-Covid-19 forecasts, by 2040, vehicles sales are expected to decrease by 23 percent in Germany and nine percent in the region of the North American Free Trade Agreement, while vehicles sales in China are expected to increase by 38 percent.

### New Competition

In addition to a shrinking market for the automotive leasing and loan business, captives are facing additional competition by new players within this declining segment, including independent leasing and fleet management companies, large private consumer banks as well as rental-car and fintech companies.

Captives have had a history of success with their traditional business model, but the era of above-average growth and record sales is expected to end over the coming years. To stay competitive, investments in new service-based



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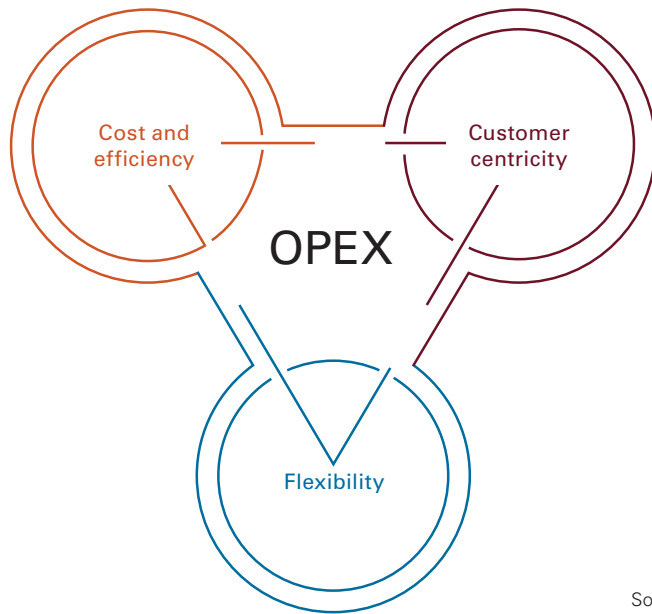
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Figure 1: "Magical Triangle" of OPEX Goals



Source: Deloitte

products and profit pools are necessary. New business models need to be developed and implemented with operating models as lean as possible. To free up the required funds for this endeavor, captives are under pressure to reduce costs in their traditional business. Operational excellence (OPEX) helps them transform their current operating model, build efficient new ones, and stay competitive in the current, challenging market environment.

## Making Captives Future-Proof

OPEX supports three main goals to help captives overcome near-term challenges and leverage future opportunities (see figure 1):

› **Reduce Costs and Improve Efficiency:** Significant cost savings are achieved through more efficient processes and organization. Further, lower cost/better prices create an improved competitive position. And: freed up funds allow investments in new business models.

› **Create More Flexibility:** A more flexible organization and utilization of sourcing allows for swift adoption to

changes in demand. In addition, high level of digitalization and customer/dealer self-services make the operating model less dependent on personnel. Business process outsourcing and functions-as-a-service help to source skills externally that are not available in-house. And: A faster time-to-market can be achieved by lean products and processes.

› **Improve Customer Centricity:** Optimized processes allow for more focus on customer/dealer needs and value-add, seamless and convenient customer/dealer experience, fast and efficient processes as well as response to customer/dealer inquiries.

»It is crucial to encourage active participation among employees and management.«

Online origination helps provide more direct interactions with customers. Last but not least, products, processes, and interactions such as less variations or fewer information requirements are simplified.

Excelling in efficient business operations will be the foundation of any

future captive business model and a crucial element of any successful transformation. To succeed, captives will need to implement OPEX based on company-wide initiatives. A holistic and structured approach of rolling out the OPEX program across the entire organization has a much higher likelihood for success than siloed initiatives in various departments.

## How to Make OPEX a Success

Before starting the improvements, it is strongly recommend to invest time in defining a structure that fits the company's individual circumstances. The approaches range from a continuous improvement process to a dedicated OPEX program with various alternatives in between. As the prior takes time to show effects and only rarely results in major changes or large savings, a full-fledged OPEX program is recommended: it usually results in a significant change in mindset within a relatively short period of time. This more centralized approach helps introduce structural and organizational improvements with high impact complementing any bottom-up changes.

The focus of this article will be on providing further insight into the OPEX program, showing a tried-and-tested approach for introducing OPEX initiatives in four main phases, as depicted in figure 2. Companies will require both a dedicated change management and a governance backbone to support the four phases. Since optimization initia-

tives often challenge the established way of working, they affect most employees directly. This may cause resentment and require a lot of communication as well as collaboration with employee representatives. At the same time, it is crucial to encourage active participation among employees and management in an effort to identify and

ultimately implement the right optimization measures. Providing a comprehensive OPEX narrative makes this trade-off more convincing, especially as the change management is part of every phase of the program. Amongst others, a compelling OPEX story strongly outlines the “Why”, fosters out-of-the-box thinking and encourages a positive feedback culture.

### Set-Up Phase

The more elaborate the design of the OPEX program is prior to implementation, the greater the efficiencies will be along the way. Three dimensions – People and Organization, Tools and Templates as well as Processes – help to structure the set-up phase.

› Within **People and Organization**, the focus is on securing senior management buy-in and creating a clear narrative for the corporate communication including goals and aspirations.

The set-up of the necessary governance structures defining uniform rationales for, among others, business case calculation or target tracking is key to enable the organization. Target agreements across the business units are necessary to anchor clear responsibility and accountability.

› **Tools and Templates** will be critical for the program success because they create transparency for a huge amount of data, increase efficiency and ensure compliance in the program activities. Examples are initiative profiles summarizing important information, software tools aggregating information and data management tools to create a single source of truth.

› Established OPEX program **Processes** serve primarily as a framework for the organization to ensure quality, efficiency and compliance. Therefore, an initiative lifecycle concept gives guidance on how efficiency measures are processed from an early stage

idea to final implementation. They follow clear criteria which must be met to reach the next higher stage of the lifecycle (Degree of implementation-DOI-Model). Decision boards hereby serve as gatekeepers approving initiative profiles and business cases before being implemented. Also, an authority should be established that prevents loss of already planned/decided savings, increase in implementation costs or initiatives from being completely withdrawn.

### Ideation Phase

The main goal of the Ideation Phase is to back the defined program targets with initiatives, resulting in a portfolio of savings initiatives. Here, the focus is on identifying suitable and impactful initiatives without ever losing sight of the bigger picture. The key is to balance the portfolio and create an optimal savings ramp-up. To safely meet the set overall savings targets, goals should be

# Zeit für den Mittelstand

## Sale & Lease Back Finanzierung für Ihre Investitionskraft

Das Verkaufen und Zurückleasen von gebrauchten Maschinen bringt viele Vorteile:

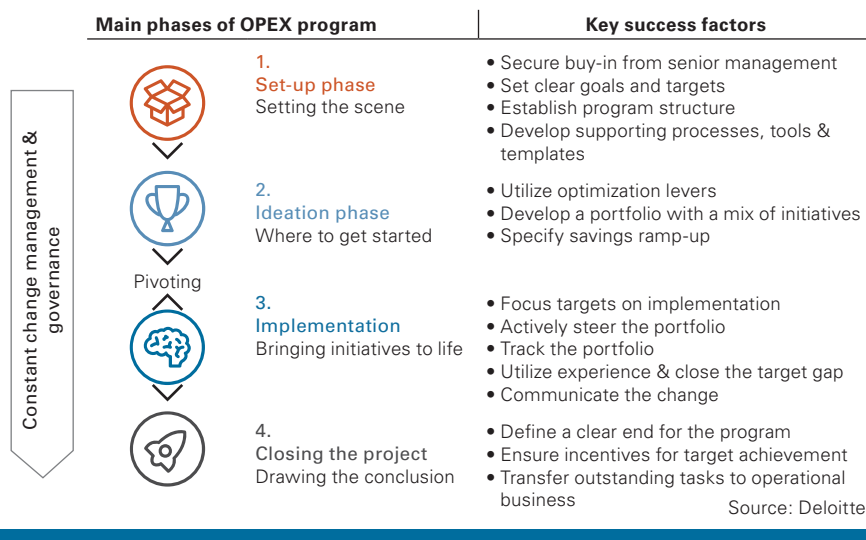
Kurzfristige Generierung von Liquidität // Steuerliche Absetzbarkeit der Leasingraten // Verbesserung der Eigenkapitalquote // Pay as you earn – Leasingraten finanzieren sich aus erwirtschafteten Umsätzen // Keine Einschränkung bei der Nutzung des Anlagevermögens

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Figure 2: Schematic Structure and Key Success Factors of an OPEX Program



to overshoot the targets during the program duration by 20-50 percent to cover for savings reductions or implementation failures.

To identify initiatives, companies should think in four main action clusters: Elimination, Improvement, Sourcing and Automation. Figure 3 outlines Deloitte's aggregated project experience structured by the action clusters that make up the OPEX playbook. It aims to give practitioners guidance during the Ideation Phase and helps them curate the optimal portfolio of program initiatives.

## Implementation

The program should start with implementing decided initiatives as soon as possible to generate early success. After the savings goal (plus a buffer of 20-50 percent) has been backed by ideas, the project focus should shift largely towards implementation. To support this, companies need to make the implementation of these measures part of the target agreements of business unit leads. The focus of a balanced portfolio is to implement quick wins and secure savings on a consistent basis, while also promoting long-term initiatives. Some projects could encounter unforeseen issues during the Implementation Phase. As these effects have a direct impact on profit and loss, it is

vital to follow a proper tracking and mitigation plan. To close a potential savings gap, it is important to develop new ideas and measures: for instance, foster know-how exchange or develop more radical ideas, based on the OPEX playbook.

The longer the program is in progress, the more uncertainty will increase among employees, especially where their direct working environment is affected. Establishing a dedicated transformation office can help focus the communication on overcoming uncertainty and providing security as well as highlighting new prospects for affected employees. It is crucial to have the majority of employees on board with respect to the root causes behind the OPEX program, for example overall job security, elimination of non-value add activities and equality in the allocation of tasks.

Based on the OPEX playbook (also figure 3), the following two deep dives will provide detailed insights on two important levers: Digital Self-Services as well as Artificial Intelligence.

› The successful roll-out of **Digital Self-Services** is observable across various industries – for instance, in e-commerce, banking and mobility. Companies use digital self-services to reduce their back-office costs and

provide a more seamless customer experience. The usage also facilitates the collection and analysis of customer data, which provides better customer insights. Although there is a clear potential for cost savings, captives have not moved past the early stages of digital self-services development and have yet to reap their full benefit. Customer interaction with captives is still mostly based on e-mails, letters, faxes as well as phone calls with customer service agents – a huge cost driver. Based on previous experience, captives can cut their operating costs by 15 percent to 20 percent by introducing digital self-services.

**Use Case:** A multinational automotive captive digitalized the customer journeys for all global financial services products. The challenge was to manage an end-to-end product roll-out across brands into all target markets and meet pre-defined management objectives. In order to succeed, a standardized joint roll-out approach for asset-based and non-asset-based products that aligned core elements of the digital customer journey by product had to be developed. With a dedicated project steering team, a single point of contact for all markets and defined standardized functional and technical requirements could be ensured. This also allowed for centralized market readiness and vendor capability assessments for innovative features, including digital account check, e-legitimation/e-signing and online credit approval.

The project resulted in a modular architecture for digital customer journeys across all products, brands and markets. The shift to digital self-services and automation significantly reduced back-office costs. Furthermore, the captive met the management objectives with efficient market rollouts and continues to improve on the roll-out efficiency while deploying additional features across the digital customer journey.

› Most captives have begun to embrace the increasing importance of

**Artificial Intelligence (AI)**, developing initial proof of concepts or rolling out AI support for a few processes or products – but they are still far from leveraging its full potential. Common areas of application for automation include fraud detection, chatbots or the credit assessment and underwriting process. For the latter, basic AI solutions can achieve a higher throughput rate in credit decision and application processing than human employees. Sophisticated AI solutions can do much more to optimize the entire process and enhance decision quality.

For example, they can use digital footprints, algorithms and data points to gain new and complex insight and assess online shopping habits, payment

tion is identifying and developing suitable use cases. In general, developing an AI solution is a two-step process. AI incubation is the first step, where teams generate initial ideas, prioritize the top candidates and evaluate the solution in both technical and economic terms to define a proof of concept (PoC). Then they gather the data needed for this PoC and process it as needed to train the AI model. Iterative testing and improvement of the model is a core element of the development process to ensure scaling and productionizing of the solution in a second step on the selected platform architecture.

**Use Case:** Bringing theory to action, Deloitte teamed up with mobile.de to predict the impact of vehicle configura-

ommends ways to configure packages and trim levels to increase long-term appeal and hence reduce residual value risk.

## Closing the Project

When the program is moving towards the scheduled completion date, it is time to draw a final conclusion on the achievements, even if some tasks are still outstanding. To stay “ready for the future”, the operational business units will still have to implement outstanding tasks as part of the continuous improvement process and conduct the tracking to realize the savings.

Thanks to the consistent communication strategy and the organizational impact of the OPEX program over the previous few years, the organization in question is likely to have changed its mindset to a more efficiency-oriented one and paved the path towards a more efficient organization.

## OPEX in the DNA of Automotive Captives

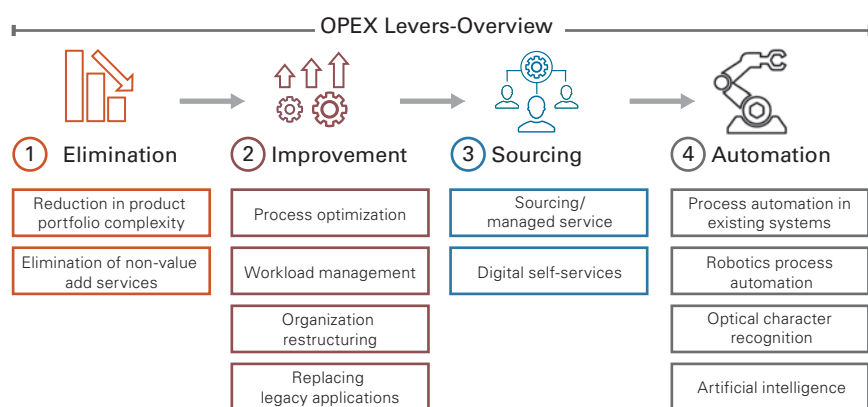
To meet the shifting customer demand regarding products, services and digitalization as well as to operate efficient business models, operational excellence must become part of the DNA of automotive captives. Freeing-up funds for design and implementation and streamlining their operating models, therefore, is a key priority.

Among other levers, digital self-service and artificial intelligence offer effective ways to optimize new and existing operating models. Deloitte’s OPEX playbook provides hands-on guidance for practitioners with clear approaches, leading practices and additional efficiency levers from process optimization, organizational improvements to sourcing and automation.

### Footnotes

- 1) Daimler AG, Annual Report 2019, 2020.
- 2) Bayerische Motoren Werke AG, Annual Report 2019, 2020.
- 3) <https://www.vwfs.com/en/investor-relations/volkswagen-financial-services-ag/annual-reports.html>

Figure 3: OPEX Playbook



Source: Deloitte

history for utility and telephone bills or social media profiles to determine creditworthiness. At the same time AI helps companies make their business more customer-centric with AI-enabled predictions about customer preferences as well as future behavior which lead to highly personalized offers and services, enabling captives to generate additional revenue and increase customer satisfaction and loyalty.

A central issue for companies looking to pick up the pace of their AI adop-

tion on residual value based on used car data from more than five million transactions per year available across all brands and car ages. They used a regression model to mine this data for a full analysis of the relationship between features and value. The model ranked every single specific configuration in terms of its performance versus the list price (for instance, above-par/sub-par performance), including those options with no impact at all. This tool analyzes how a specific option/package/trim level impacts the residual value of used cars and rec-