

PETER CHHIM

## **Corporate Governance within an Automotive Supplier: *Navigating the economic depression of 2008/2009***

Tony Harrick was worried. As EXTRIM Corporation's new VP of North American Operations, Tony was only a few months on the job but knew that he had to act quickly in order to keep EXTRIM's operational costs from crippling its balance sheet. The company was performing extremely poorly, and the general consensus was that it needed to be 'right sized'<sup>1</sup> in order to match reduced sales volumes from the recent economic depression. In addition, concern was palpable throughout the organization as both the work force and company ownership were concerned with the stability of the global economy and its effects on the labor market. Were there going to be mass lay-offs? Would the company be sold, or would it go into bankruptcy?

As he sat back in his chair and began analyzing the various thoughts within his head, the phone rang. Tony picked it up and on the other line was his boss, EXTRIM's CEO, Eric Smith.

Eric was a brute of a man, large in physical dimensions, with a booming and assertive voice. Prior to hiring Tony, Eric had promised EXTRIM's board of governors that the company would be right sized within the year and that he and his team would manage the company's cash flow in order to prevent any profit loss. However, Eric didn't foresee the severe magnitude of the recession and its impact on the company's sales volumes. He knew that changes were needed immediately if he were to keep the company from operating with a negative cash flow. However, Eric was not as intimate with the operations side of the business and left that portion of the plan for Tony to define.

"Tony, we have an emergency meeting with the board of directors next week. Accounting has told me that our operations side of the business is squeezing the profits out of our margins and unless we make some immediate changes we won't be able to continue to operate in the black. The board has caught wind of this and they want to know what our plan is."

"Ok Eric. I've been reviewing each plant's performance metrics, and I think I should have a plan together soon to get our operational costs in line with our sales volumes."

"Tony, with all due respect, this is both of our futures on the line. I'll need you to be more certain of your recommendations. You can't just 'think' you'll know, you'll need to 'know'. The board will want a bullet proof plan, and if you show any signs of uncertainty they'll tear us apart."

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<sup>1</sup> Right size – a term used to describe adjusting the size of an organization to effectively accommodate its sales volumes.

“Understood Eric, I’ll have our plan ready for review by the end of this week. We can go over it during the weekend, and be prepared for our board meeting next Tuesday.”

“Good Tony, I look forward to seeing it.”

After Tony put the phone back in its receiver he gave out a large sigh, this won’t be nearly as easy as he made it seem. Operationally the plants weren’t performing well, and with additional cuts the strain on resources could jeopardize the organizations overall performance. This could end up damaging the company’s brand while still putting it into a negative cash flow situation. Tony knew that his plan might ultimately decide his and Eric’s fate with the company so he knew that the plan he was going to propose had to be fundamentally sound.

## BACKGROUND

EXTRIM Corporation is a privately owned U.S. supplier of automotive *exterior trim*<sup>2</sup>, focusing primarily on luggage racks and truck bed accessories. The company’s core business centers on products for SUVs<sup>3</sup>, Trucks, and Minivans. It has been in business for over 50 years and has a global customer base that consists of nearly all prominent OEM<sup>4</sup> automobile manufacturers. In recent years, it has expanded its customer base to include clients outside of the automotive industry; however, its primary business still remains with the domestic automobile OEMs.

As sales for SUVs and Trucks grew to record numbers in the 1980s and 1990s, EXTRIM Corporation did exceptionally well as its products were making their way onto more and more vehicles. Its take rates<sup>5</sup> for its products were traditionally around 95 – 100%. Unfortunately though, the recent economic downturn of the 21<sup>st</sup> century was causing a consumer shift from SUVs and trucks to smaller, more fuel efficient, passenger cars. Since EXTRIM products were not typically used for these vehicles, the company’s sales volumes dropped in accordance to the consumer shift.

Exacerbating matters further, as gas prices reached record highs and the global economic recession caused millions to lose their jobs, many U.S. families could simply not afford or justify the luxury of purchasing a pricey SUV over a cheaper and more fuel efficient passenger vehicle.

These sentiments were echoed by Toyota Motor Sales President, Jim Lentz, who was quoted as saying that, "Smaller vehicles are going over big. With oil prices at record levels, compact cars and hybrids continue to lead the way."<sup>6</sup> Ultimately, this meant that EXTRIM Corporation was selling fewer of its products, and consequently its overall revenue and profits were shrinking.

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<sup>2</sup> Automotive exterior trim – functional or styling components such as side mirrors, door handles, roof racks, grilles, bumpers, etc., located on the exterior of an automobile

<sup>3</sup> SUV – Sport Utility Vehicle

<sup>4</sup> OEM – Original Equipment Manufacturer

<sup>5</sup> Take rate – percentage of OEM base model vehicles that receive a particular product

<sup>6</sup> Toyota Motor Corporation is a leading global automotive OEM with significant market share in the U.S. and operates in North America under the name Toyota Motor North America, Inc. It is considered a leader in automotive manufacturing best practices.

As the global recession continued along and overall sales figures in the industry declined (**Exhibit 1**), many automotive OEMs were looking for ways to cut costs. One strategy to do so was to selectively *de-content*<sup>7</sup> their vehicles. What this meant was that items that were not considered integral to consumer value were removed from the vehicle's base model, thus lowering their overall cost as well as the ever so psychologically important, sticker or advertisement price. Unfortunately for EXTRIM Corporation, their commodity group fell into this grouping. This meant that the company's sales volumes would be reduced as some of their products would be de-contented.

As these realities began to take shape, the prevailing notion within EXTRIM Corporation was that if senior management was not able to navigate through these turbulent times, the company would not survive. While the management team realized that it could not control the external factors of its environment, it did recognize that it could control its internal operations, and consequently affect its overall profit margin.

## OPERATIONS

The organization has four manufacturing facilities in North America (**Exhibit 2**). Three of these facilities are located in the Midwest, while the other is in the southern state of Georgia. The Midwest facilities include an Assembly Plant in Maumee, Ohio, a molding and assembly facility in Saline, Michigan, and a roll form and stamping facility in Shelby Township, Michigan. The Georgian facility is located in a rural part of the state called Carrollton and manufactures and assembles aluminum extrusions.

Other than the facilities in Georgia and Ohio, all plants currently operate on a single shift. During the SUV and pickup up truck booms in the late 80's and 90's, EXTRIM's plants were all running near full capacity and each worked either 2 or 3 shifts (8 hours each). However, the current economic climate called for significantly reduced volumes, and consequently, EXTRIM Corporation had to adjust its operating patterns to reflect the change in demand.

The Shelby Township plant is EXTRIM's smallest facility and is primarily responsible for supplying its internal customers, i.e., the other EXTRIM plants, with its *roll formed*<sup>8</sup> components. The Saline facility is the home of the Corporations *molding* operations, and during previous times the plant was staffed for three shifts. However, in its current state the plant has open capacity which means that it is able to fill its production quotas within two shifts. The Georgian and Ohio plants are both largely *assembly* plants and need to work two, and occasionally three shifts to meet the demands of their various customers. While the Georgian facility is an older one, historically it does not have as much experience supplying the automotive OEMs as the Ohio plant (which was setup a decade earlier for exactly this reason). See **Exhibit 3** for details of EXTRIM Corporation's Operational plan for its facilities.

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<sup>7</sup> De-contenting – A term used to describe the elimination of certain product as standard vehicle items, and instead making them available through option packages.

<sup>8</sup> Roll Forming is a continuous manufacturing process whereby long strips of coiled steel are passed through rolls and gradually bent until the desired cross-section profile is obtained.

The number of OEM customers that each EXTRIM facility supports varies by plant. Traditionally, the Maumee and Carrolton facilities supply the largest number of customers because each facility was originally designed as an assembly plant and produces many of EXTRIM's final assemblies. The Shelby Township and Saline facilities are just beginning to incorporate more assembly lines within their plants (their primary responsibilities are to provide components for these assemblies), so consequently, they do not supply as many OEM customers. **Exhibit 4** shows the different OEM customers that each facility supplies, as well; **Exhibit 5** shows the various locations of EXTRIM's North American Customers.

Operationally, EXTRIM's executive management defines four primary metrics for each of its plants to manage (see **Exhibit 3** for examples of each metric from EXTRIM's Shelby facility). These are:

- (1) OEE<sup>9</sup>
- (2) Scrap<sup>10</sup>
- (3) PPM<sup>11</sup>
- (4) On-Time Delivery<sup>12</sup>

At the end of each month, every plant submits their performance metrics to an executive administrator who aggregates them into collective metrics for executive review (**Exhibit 6**).

A review of each metric is as follows:

OEE is a performance metric that quantifies how well an operation is performing relative to three underlying categories, namely, availability, performance and quality. Mathematically, the metric is defined as follows:

$$OEE = Availability (\%) \times Performance (\%) \times Quality (\%)$$

A more detailed description of each category is provided below:

**Availability:** The portion of the OEE Metric that represents the percentage of schedule time that the equipment/operation is available to operate.

**Performance:** The portion of the OEE Metric that represents the speed at which the operation runs as a percentage of its designed speed (typically, speed is measured in units/hour).

**Quality:** The portion of the OEE Metric that represents the number of 'Good' units produced as a percentage of the total units produced.

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<sup>9</sup> OEE – Operating Equipment Efficiency, or OEE, is a performance metric that combines equipment availability, performance, and quality.

<sup>10</sup> Scrap – Product that does not meet customer requirements and has been designated for disposal or recycle.

<sup>11</sup> PPM – Parts Per Million. A performance metric used to track the performance of part quality. PPM = Fraction of defective parts \* 1,000,000 (e.g., if 3 parts are defective in a batch of 1000, PPM = (3/1000)\*1,000,000 =300).

<sup>12</sup> On-time – Refers to the delivery of product within a specified time frame.

While there are no universally accepted OEE values for so called, ‘world class’ performance, the following values are commonly cited in industrial literature.

### **WORLD CLASS OEE**

<b>Availability</b>	<b>95.0%</b>
<b>Performance</b>	<b>95.0%</b>
<b>Quality</b>	<b>99.9%</b>
<b>OEE</b>	<b>90.0%</b>

EXTRIM Corporation measured its Scrap metric in terms of its percentage of sales. Its target value for all its facilities is 1%. The metric is defined as:

$$\textit{Scrap} = \textit{Cost of scrap} (\$) / \textit{Sales dollars} (\$)$$

This metric allows the company to measure its scrap costs in terms of its impact on sales dollars, a useful approach when helping to forecast future budgets. However, a critique to of this method is that since it is tied to goods sold; one can somewhat mask issues simply by increasing sales volumes. Inversely then, it can also overinflate issues when these dollars are lowered.

Customer PPM is a commonly used metric in the auto industry and is intended to help gauge a supplier’s performance in terms of part quality. The metric is measured as a ratio between the ‘number of parts received’ vs. ‘the number of parts rejected’. Since this ratio is typically small, it is multiplied by a factor of 1,000,000 to increase its value and provide a sense of how the supplier will perform over a longer period of time.

$$\textit{PPM} = (\textit{Parts rejected} / \textit{Parts received}) * 1,000,000$$

An inherent flaw with this factor approach is that it assumes that the defect rate will remain constant over time. However, this is typically not the case as various factors can affect part quality and hence make the defect rate quite dynamic.

EXTRIM’s delivery metric is measured as a ratio of the number of delivery trucks that were shipped to its customer’s on-time vs. not-on time. The formula for determining the percentage of on-time deliveries is this ratio multiplied by 100.

With each of EXTRIM’s plants underperforming, the challenge of right sizing the business increases in complexity as moving resources can have both a positive and negative impact on the affected facilities.

To gain a better grasp of the individuals involved in this realignment, Tony asked for an organization chart of each the organizations facilities (see **Exhibit 7**).

## **CORPORATE GOVERNANCE**

The term corporate governance deals with the protection of shareholder interests through mechanisms which are designed to prevent misappropriate use by company officials. In nearly all cases, investors are protected by the enforcement of laws and regulations. Some of these rights include disclosure and accounting rules that provide transparency to business financials, receiving dividends on pro-rata terms<sup>13</sup>, being able to vote for company executives, participate in shareholder or board meetings, and calling extra-ordinary meetings.

While corporate governance varies between industries and nations, some popular espoused principles are provided in **Exhibit 8**.

EXTRIM Corporation is held through a large private equity firm called Annex investment group. The firm has multiple organizations within its portfolio and its key mission objective is to deliver significant financial return of investment to its shareholders. To help ensure this objective is met, the firm established a 'board of governors' that meets quarterly with the top executives of each of the companies it owns. During these board meetings, which can often become heated due to the large monetary value at stake, the board reviews the organization's current performance<sup>14</sup> as well as its performance to plan, and provides feedback to the company's executive committee.

Being cognizant of the financial strain caused by the recent economic depression, the board has begun paying much closer attention to the performance of each of the companies it owns. In particular, it has kept a close watch on its automotive holdings as the downturn in automotive sales has crippled revenue throughout the industry. In recent reviews of EXTRIM Corporation's performance metrics (**Exhibit 6**) and profit and loss statement (**Exhibit 9**), the board has become alarmed by the company's performance and its financial situation. In addition, forecasting estimates for the coming years only show small changes in overall sales volumes (**Exhibit 10**). Given current performance, the board is not happy with the direction of recent trends, specifically as it relates to profits.

In an attempt to reverse the company's fortune, it has requested an emergency meeting with EXTRIM's executive committee.

## TONY'S DILEMMA

Tony knows that the proposal he puts in place will have a great impact on the financial investments of the company's shareholders and that his own future with the company is at risk. So as his meeting with Eric nears, he is vexed by two questions he believes are imperative to the development of his operational plan. One, how should he go about evaluating EXTRIM's recent performance and the intellectual capital within the organization? And two, given the uncertainty of the market, and an industrial consensus towards down-sizing, should he risk his career by submitting a plan other than that which is expected? How would Eric and the board receive it, and does he have any other choice?

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<sup>13</sup> Pro-rata – based on a factor defined by length of time

<sup>14</sup> When reviewing performance, the board can ask to see data from multiple functional areas such as quality, delivery, operations, finance, etc.

## Exhibit 1 – Impact of recession on U.S. automotive sales during 2008

**Vehicle Sales in Percent****December 2008\* & Year 2008\*\***

*Unadjusted—December 2008 and December 2007 had 26 selling days;  
2008 had 308 selling days, 2007 had 307 selling days*



Source: Edmunds.com

**Exhibit 2 – Locations of EXTRIM Corporations various facilities**Within North America:

*Roll Form & Assembly Facility located in Shelby Township, MI*

Number of Employees: 50 – 100

Work Schedule: 2, 10 hour shifts per day, 4 days a week

*Molding & Assembly Facility located in Saline, MI*

Number of Employees: 400 – 500

Work Schedule: 3, 8 hour shifts per day, 5 days a week

*Aluminum Extrusion & Assembly Facility located in Franklin, GA*

Number of Employees: 400 – 500

Work Schedule: 3, 8 hour shifts per day, 5 days a week

*Assembly Facility located in Maumee, OH:*

Number of Employees: 200 – 300

Work Schedule: 3, 8 hour shifts per day, 5 days a week



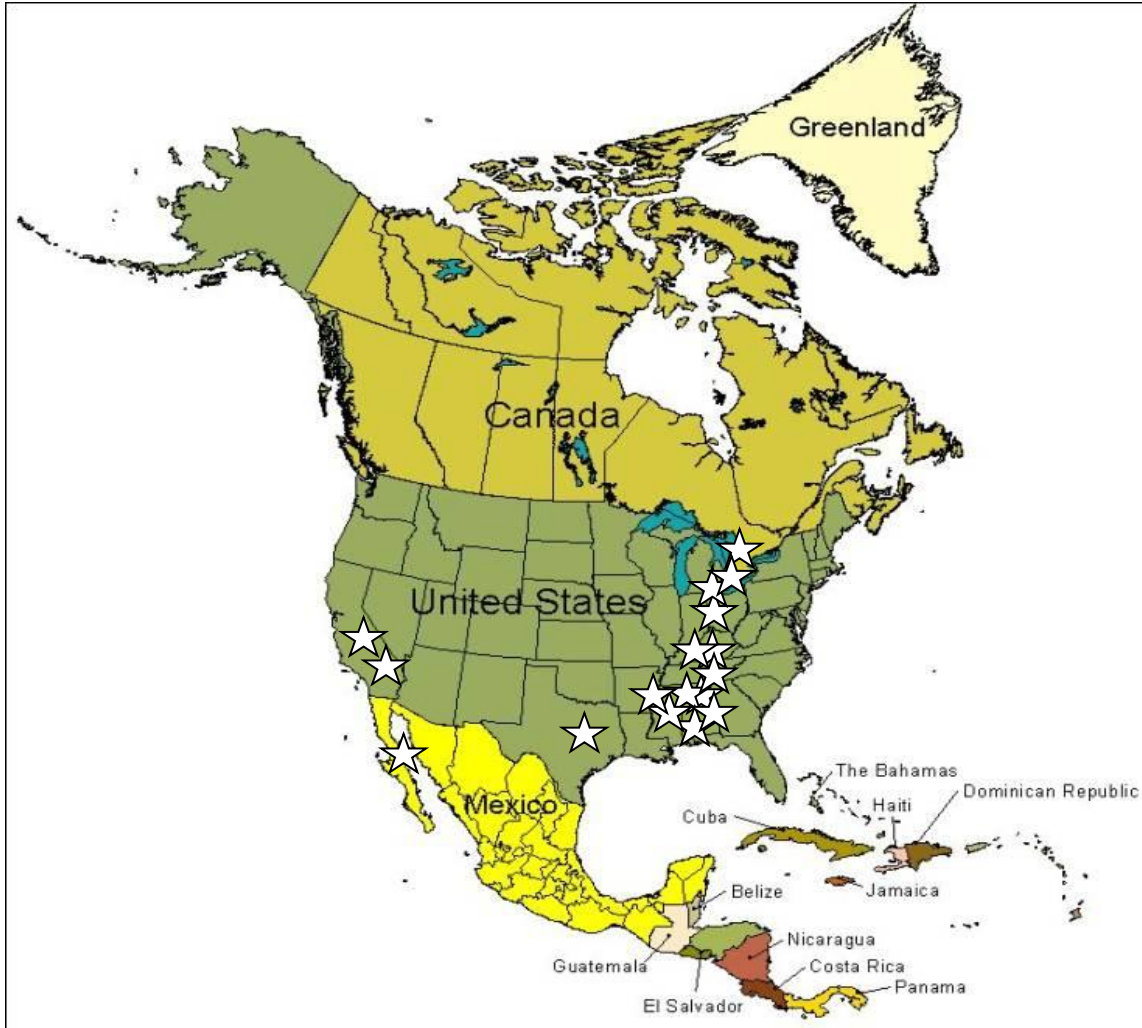
**Exhibit 3 – Current operational plan for EXTRIM Corporation’s facilities**

<b>Plant</b>	<b>Shifts Worked</b>	<b>Hours of Operation</b>	<b># of Employees (Salary + Hourly)</b>
Shelby Township, MI	1	5:00am – 6:00pm	75
Saline, MI	2	5:00am – 7:00pm	330
Maumee, OH	2	6:00am – 12:00am	250
Franklin, GA	2	5:00am – 12:00am	420

**Exhibit 4 - EXTRIM Corporation's Major Customers by Location**

<b>Customer</b>	<b>Shelby Township, MI</b>	<b>Saline, MI</b>	<b>Maumee, OH</b>	<b>Carrolton, GA</b>
Ford Motor Company	<b>No</b>	<b>Yes</b>	<b>Yes</b>	<b>Yes</b>
Toyota Motor Manufacturing	<b>Yes</b>	<b>Yes</b>	<b>Yes</b>	<b>Yes</b>
Chrysler	<b>No</b>	<b>Yes</b>	<b>Yes</b>	<b>Yes</b>
General Motors	<b>No</b>	<b>Yes</b>	<b>Yes</b>	<b>Yes</b>
Honda	<b>Yes</b>	<b>Yes</b>	<b>Yes</b>	<b>No</b>
Mercedes Benz	<b>No</b>	<b>No</b>	<b>Yes</b>	<b>Yes</b>
Kia Motors	<b>No</b>	<b>No</b>	<b>Yes</b>	<b>Yes</b>
Hyundai	<b>No</b>	<b>No</b>	<b>No</b>	<b>Yes</b>
Nissan	<b>No</b>	<b>Yes</b>	<b>Yes</b>	<b>Yes</b>
Mazda	<b>No</b>	<b>Yes</b>	<b>Yes</b>	<b>No</b>
Mitsubishi	<b>Yes</b>	<b>No</b>	<b>No</b>	<b>No</b>

**Exhibit 5 – Locations of EXTRIM Corporations North American Customers**



☆ Denotes the location of one of EXTRIM's OEM Customers

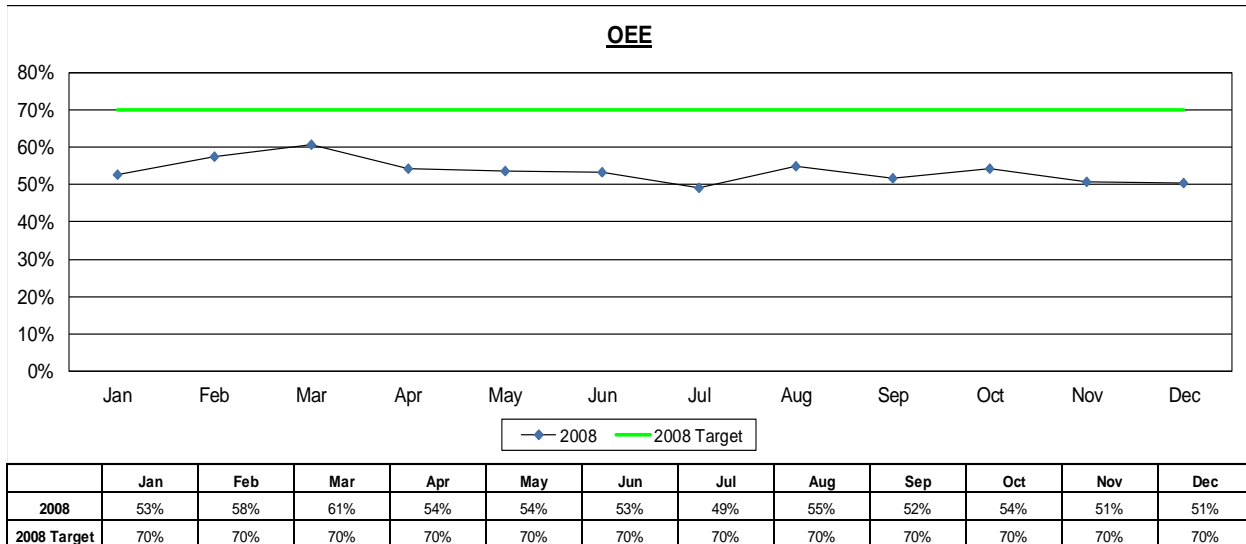
**Exhibit 6 – EXTRIM Corporation’s Plant Operating Performance Metrics**

**Shelby Operating Measurable**

2008

OEE

Champion: Production Dept.



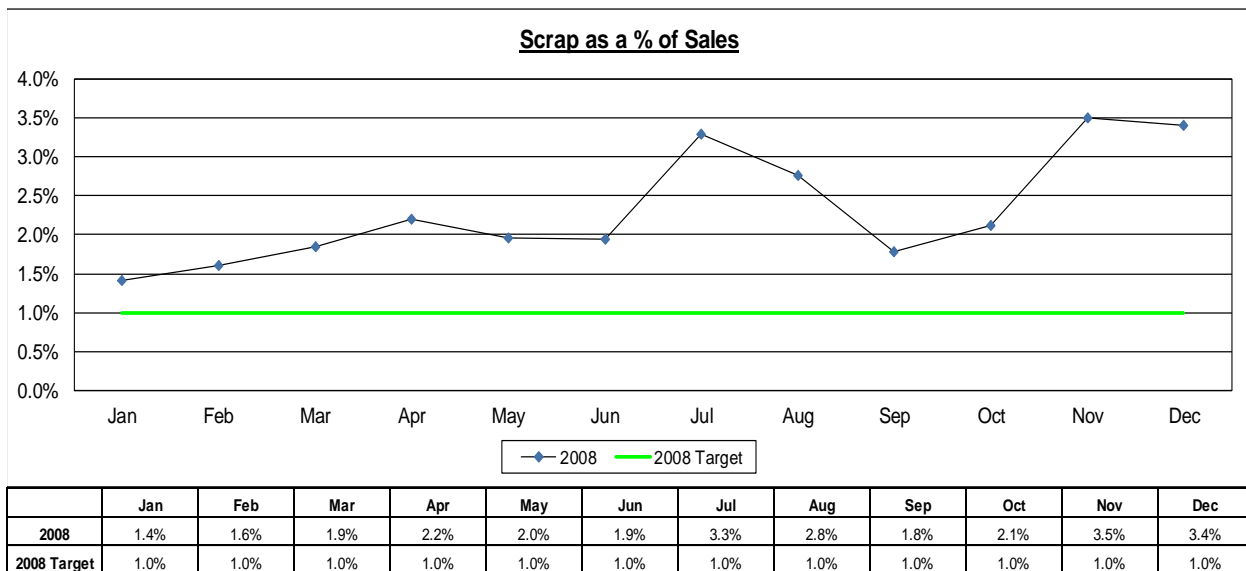
MONTH	Issue / Action Plan:	Resp.	Due Date
Dec	Roll Mill 2 down for repair / repair bearings in mill.	E. Turner	Jan-09

**Shelby Operating Measurable**

2008

Scrap as a % of Sales

Champion: Production Dept.



MONTH	Issue / Action Plan:	Resp.	Due Date
Dec	Roll Marks on Stainless Steel Jobs / Buff and polish rolls	E. Turner	Jan-09

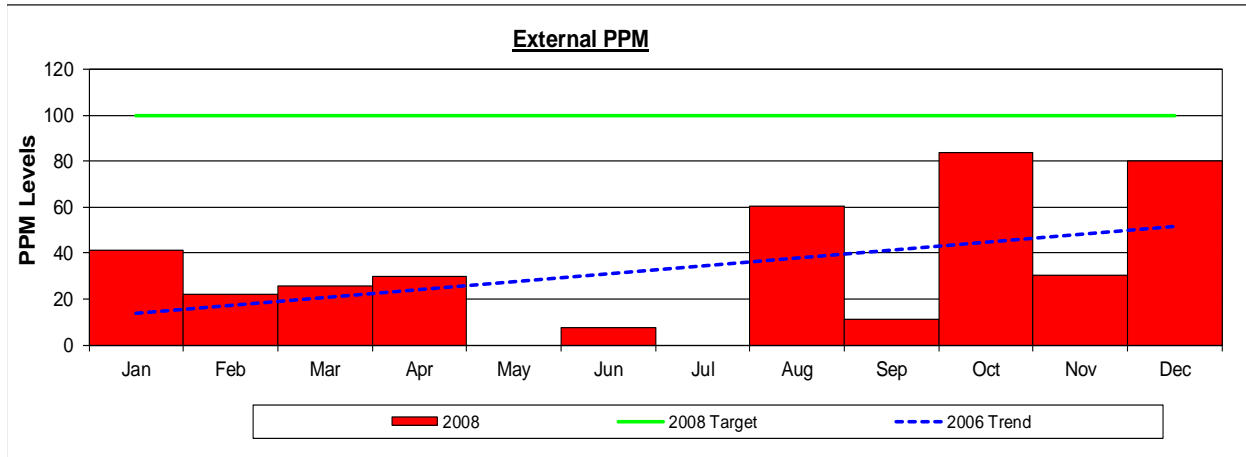
**Exhibit 6 – EXTRIM Corporation’s Plant Operating Performance Metrics Cont’d**

**Shelby Operating Measurable**

2008

External PPM

Champion: Quality Dept.



	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
2008	41	22	26	30	0	8	0	60	11	84	30	80
2008 Target	100	100	100	100	100	100	100	100	100	100	100	100

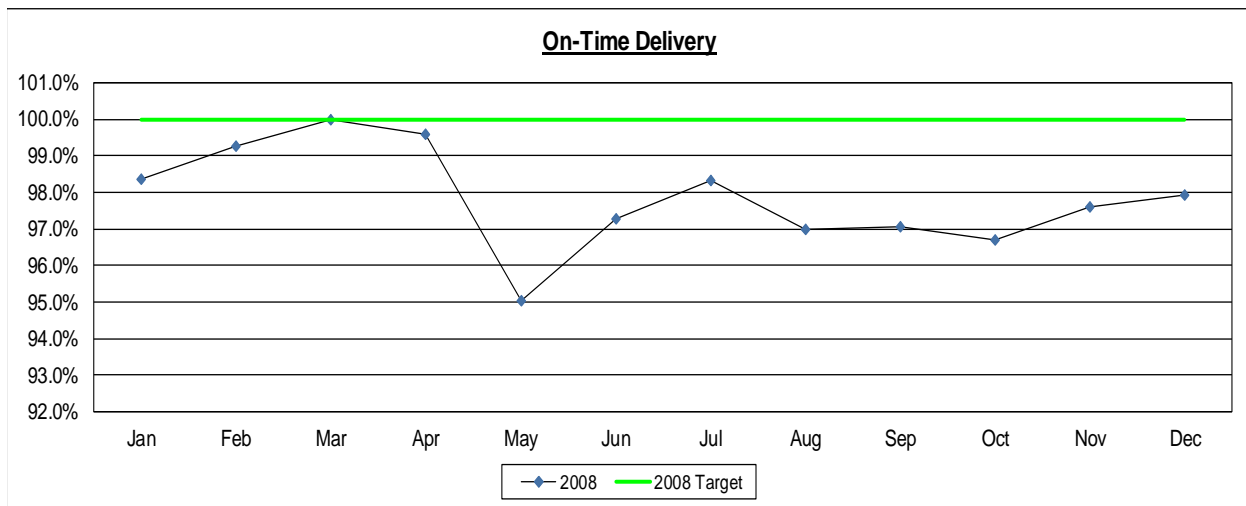
MONTH	Issue/Concern/Action Plan:	Resp.	Due Date
Dec	Broken Support / Toyota / Repair tool	J. Smith	Jan-09

**Shelby Operating Measurable**

2008

On-Time Delivery

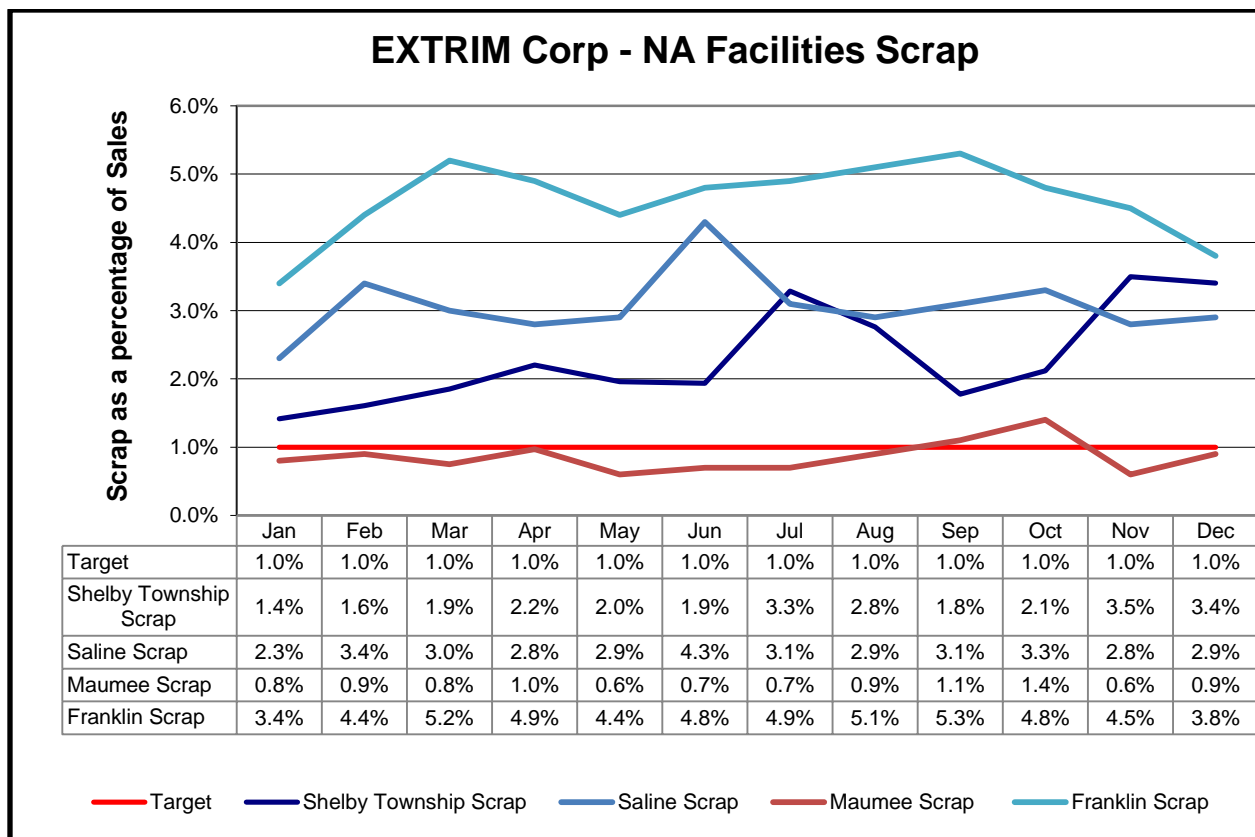
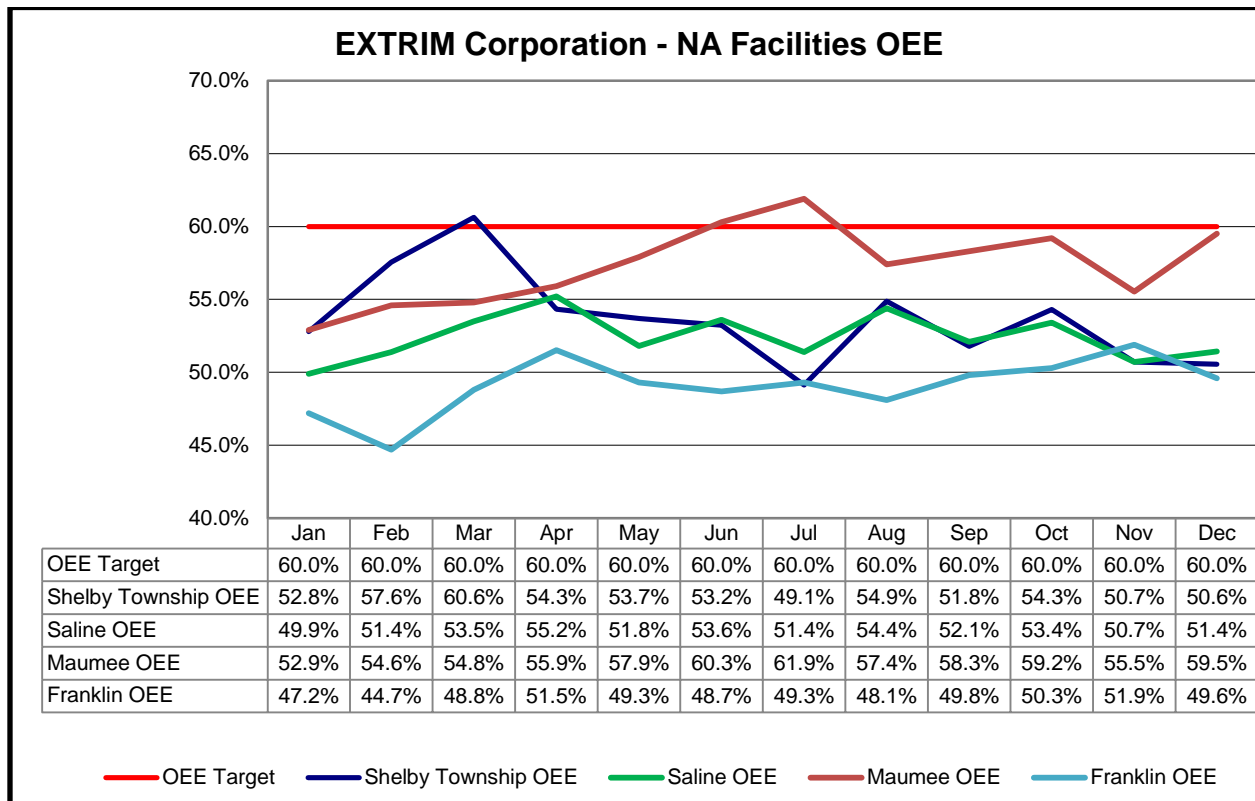
Champion: Materials Dept.



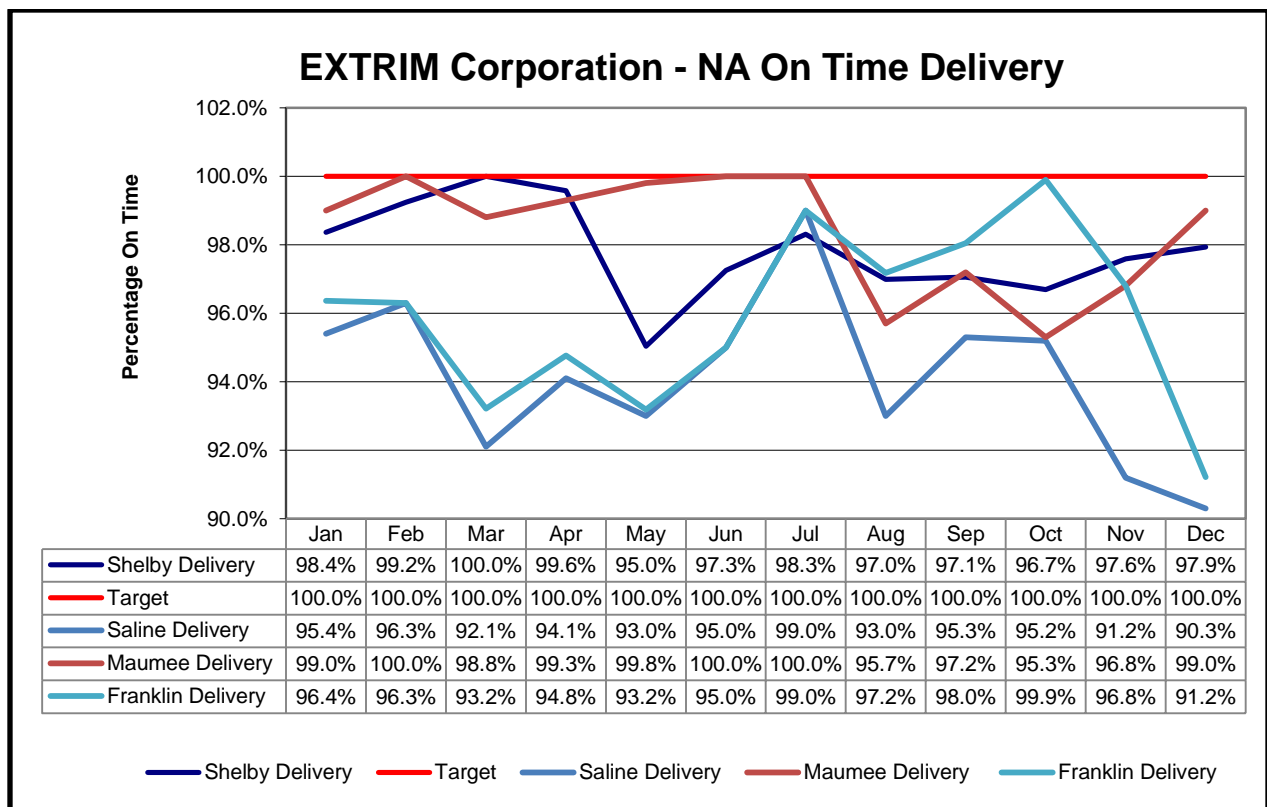
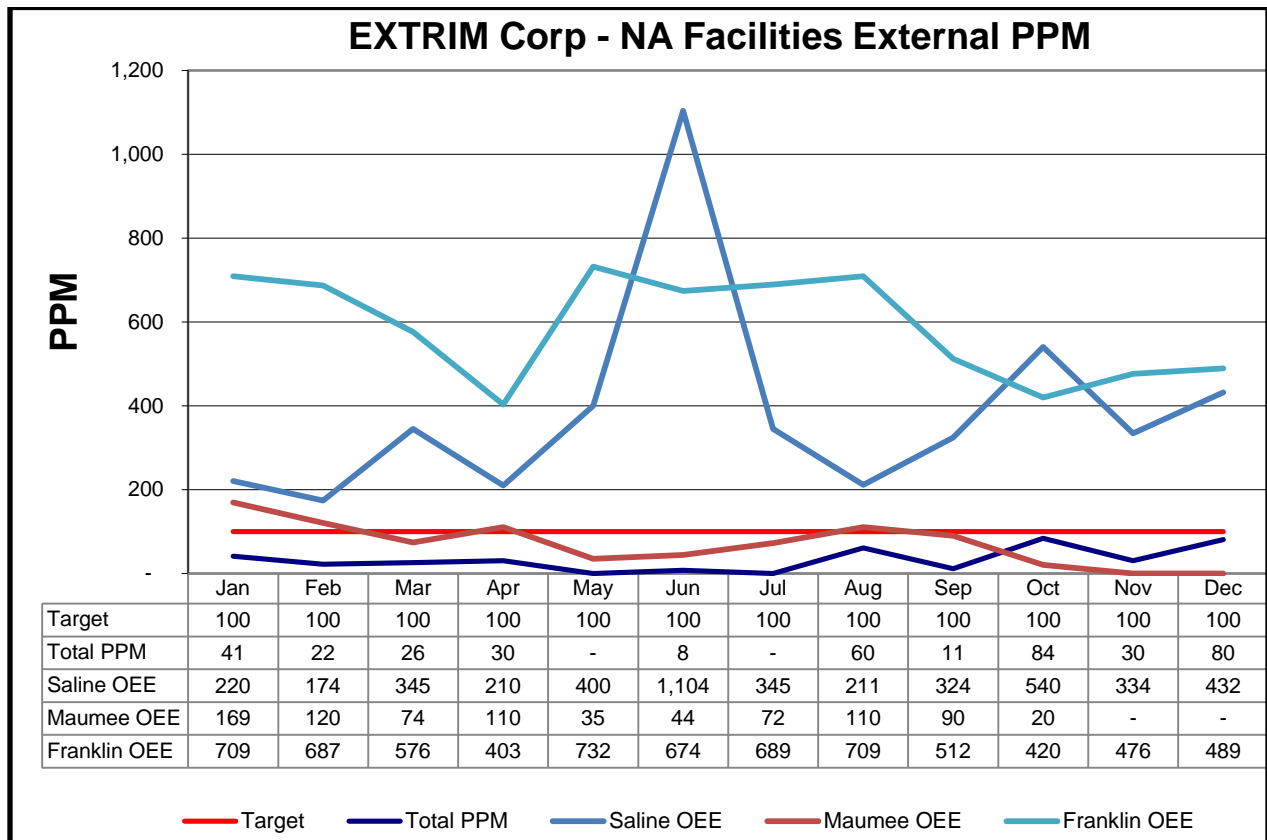
	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
2008	98.4%	99.2%	100.0%	99.6%	95.0%	97.3%	98.3%	97.0%	97.1%	96.7%	97.6%	97.9%
2008 Target	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%

MONTH	Issue / Action Plan:	Resp.	Due Date
Dec	Missed three trucks to Toyota because of inventory imbalance / Perform physical inventory, balance on-hand stock.	J. King	Jan-09

**Exhibit 6 – EXTRIM Corporation’s Collective Plant Operating Performance Metrics**

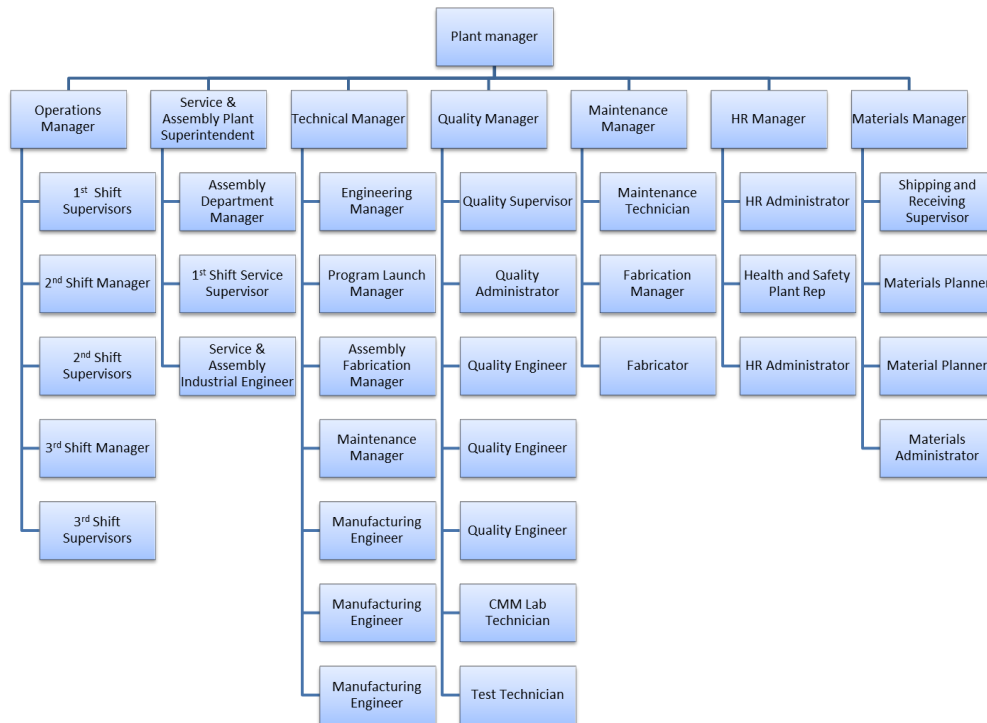


**Exhibit 6 – EXTRIM Corporation’s Performance Metrics Cont’d**

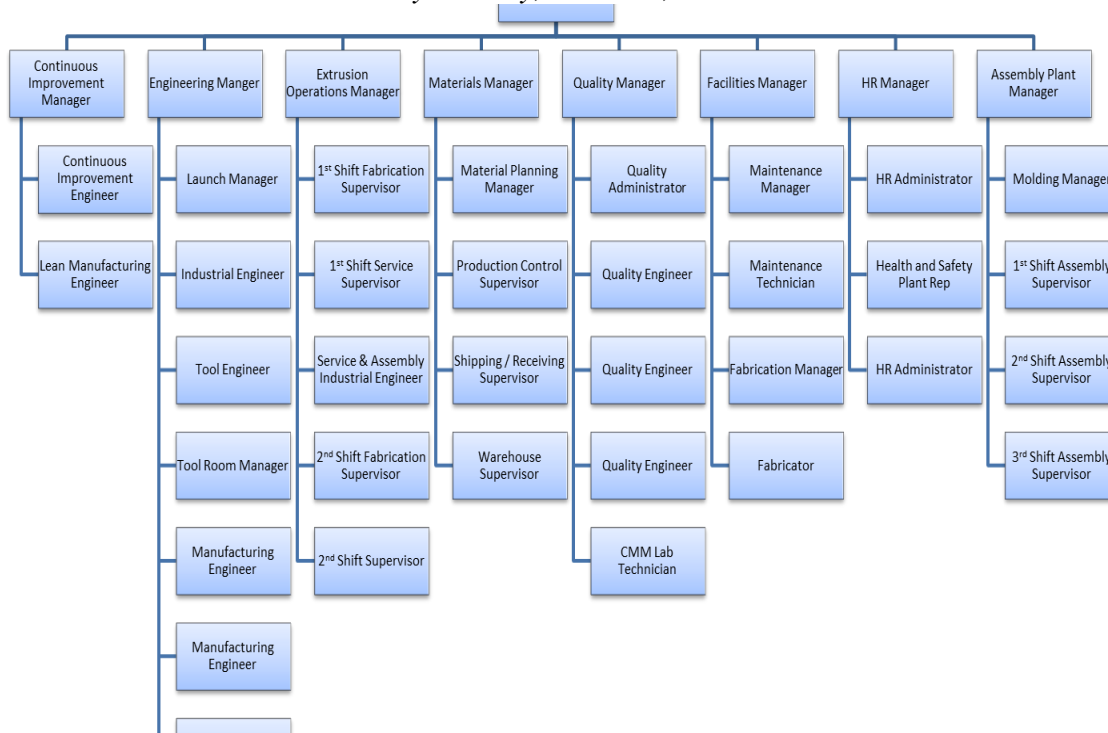


**Exhibit 7 – EXTRIM Corporation’s Organization Chart for its NA Facilities**

*Molding & Assembly Facility, Saline, MI*



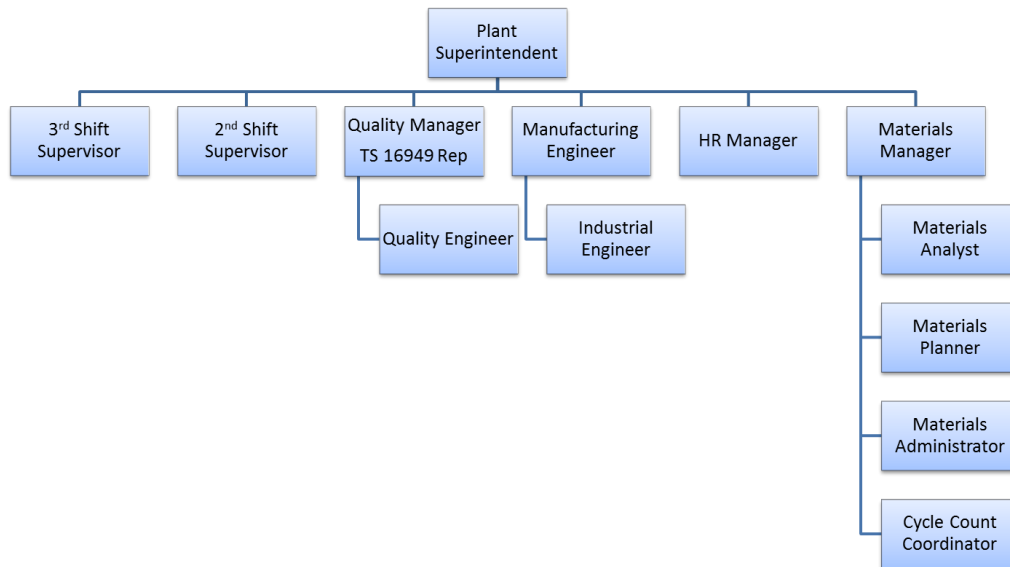
*Aluminum Extrusion & Assembly Facility, Franklin, GA*



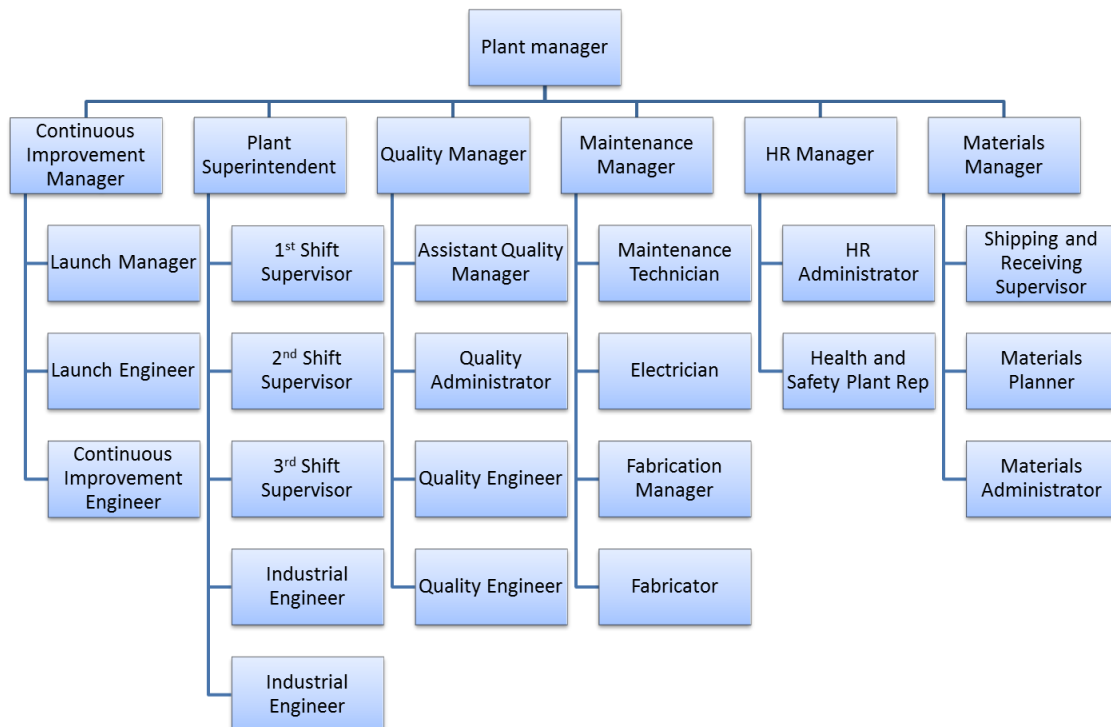


**Exhibit 7 – EXTRIM Corporation’s Organization Chart for its NA Facilities Cont’d**

*Roll Form & Assembly Facility, Shelby Township, MI*



*Assembly Facility located in Maumee, OH*



**Exhibit 8: Popular Espoused Principles of Corporate Governance**

<b>Espoused Principle</b>	<b>Code of Conduct</b>
Rights and equitable treatment of shareholders	Organizations should respect the rights of shareholders and help shareholders to exercise those rights. They can help shareholders exercise their rights by effectively communicating information that is understandable and accessible and encouraging shareholders to participate in general meetings.
Interests of other stakeholders	Organizations should recognize that they have legal and other obligations to all legitimate stakeholders.
Role and responsibilities of the board	The board needs a range of skills and understanding to be able to deal with various business issues and have the ability to review and challenge management performance. It needs to be of sufficient size and have an appropriate level of commitment to fulfill its responsibilities and duties. There are issues about the appropriate mix of executive and non-executive directors.
Integrity and ethical behavior	Ethical and responsible decision making is not only important for public relations, but it is also a necessary element in risk management and avoiding lawsuits. Organizations should develop a code of conduct for their directors and executives that promotes ethical and responsible decision making. It is important to understand, though, that reliance by a company on the integrity and ethics of individuals is bound to eventual failure. Because of this, many organizations establish Compliance and Ethics Programs to minimize the risk that the firm steps outside of ethical and legal boundaries.
Disclosure and transparency	Organizations should clarify and make publicly known the roles and responsibilities of board and management to provide shareholders with a level of accountability. They should also implement procedures to independently verify and safeguard the integrity of the company's financial reporting. Disclosure of material matters concerning the organization should be timely and balanced to ensure that all investors have access to clear, factual information.

(Source: Organization for Economic Co-operation and Development (OECD), <http://www.oecd.org>)

**Exhibit 9 – EXTRIM Corporation’s Profit and Loss Statement**

	2005	2006	2007	2008	2009
<b>Sales (In millions of USD)</b>	220	270	290	180	165
<b>Capital Investment (In millions of USD)</b>	5	7	6	5	4
<b>Depreciation (In millions of USD)</b>	5	3	2	3	4
<b>R&amp;D (in thousands of USD)</b>	300	400	500	400	300
<b># of Employees</b>	925	925	1100	700	600
<b>Operating costs (In millions of USD)</b>					
<b>Shelby</b>	10	12	16	7	6
<b>Maumee</b>	30	25	33	20	15
<b>Franklin</b>	100	120	121	77	72
<b>Saline</b>	75	110	118	75	71
<b>Profit (In millions of USD)</b>	11	11	12	4	1

**Exhibit 10 – EXTRIM Corporation’s Forecasted Sales Volumes**

