New Strategy of Continuous Improvement to Avoid Company Delocalisation in the Automotive Industry.

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Introduction

The globalised world, characterised by open competition among businesses, has given rise to the phenomenon of company delocalisation. Delocalisation is beginning to affect the most developed economic regions in Europe in a significant way. Companies must decide whether to remain in their current locations or transfer their operations to other regions where labour costs are lower. In the process of delocalisation, they would make thousands of workers unemployed and substantially reduce contributions by direct and indirect taxes to the social security system in their countries of origin. Delocalisation poses a serious threat to the economic well being of developed regions. Therefore, academic researchers have a duty to address the question of what can be done to reduce the likelihood of company delocalisation to less developed economic regions.

Many studies have addressed the problems generated by competition among businesses from a variety of different perspectives. Some have approached the question from the point of view of business strategy, identifying a number of key factors relating to the company itself, the industry to which it belongs or the region in which operates, which facilitates the company’s competitiveness and allow it to achieve a sustainable rate of increasing results (Porter, Michael (1998); Hamel, G. and Prahalad, C. K. (1994); Rumelt, R. P. (1991); Porter, Michael (1985)). Few studies, however, have analysed the capability of these factors to prevent or reduce the risk of company delocalisation. This article focuses in the rate of continuous improvement a company ought to achieve and maintain in order to counteract the threat of delocalisation to countries with lower wage costs, a threat which nowadays is more and more prevalent in Europe.

Given that it has an impact on income levels operations quality levels and cost reduction, continuous improvement has been studied in some detail as a key business factor (Delbridge, Rick and Barton, Harry (2002); Zangwill, W. I. and Kantor, P. B. (1998); Chapman, R., Hyland, P., Jenkins, R. and Sloan, T. (1997); Womack, J. and Jones, D. (1996); MacDuffie, J. P. (1995)), and it is now widely accepted that every business organisation has the capacity to continuously improve in the course of its normal functioning.

However, very little research has been carried out on the possible link(s) between the decision to delocalise a company and its savings, generated by improvements in working practices and knowledge acquired at the original location. As several studies have pointed out, these savings cannot be regarded as given because they depend on a number of factors, including the company’s structure, management systems and strategy, employees and use of technology.

This article focuses in the context of multinational company delocalisation from more developed economic regions in Western Europe to new locations in Eastern Europe where salary costs are lower. The delocalisation phenomenon is particularly pressing in the case of Spain where the presence of many multinational companies is vital in the economy’s industrial production. They provide employment to a large number of people in the areas where they are located; they are an invaluable source of wealth creation and, as a result, constitute an economic resource to be protected and retained. Company plants are located in different regions throughout the country, but with similar management systems, products and production processes. Each company assigns an annual production quota to each of its plants, in line with the company’s scale criteria, of which the most important is, of course, the profit maximisation.

Assuming that management systems, production processes and products can be transferred easily to other regions with lower labour costs, the purpose of this study is to establish the continuous improvement rate, necessary to prevent the delocalisation of multinational company plants from locations in Western Europe to new locations in Eastern Europe.
Higher standards of living and the structure of labour markets mean that average salaries are considerably higher in developed countries than in undeveloped countries.

Consequently, and given the fact that the European Union guarantees a free movement of people and goods, and that the enlarged Europe is the consumer market target, many companies have begun to consider the possibility of opening production plants in countries such as Poland, the Czech Republic, Slovakia and/or of transferring existing company operations in Western European countries to new locations in the East.

Since the different locations offer similar production levels and significant differences in wage costs, the location of operations becomes an important factor in management strategies to maximise profits to the company’s shareholders. Company management has two options to choose from:

A. Retain its plants in an economy with higher labour costs, but putting new strategies in place at the same time to ensure that the company becomes more profitable in the medium to long term; or:

B. Move its production plants to new locations and reaps immediate economic rewards in the short term through lower wage costs.

**Methodology**

The methodology designed to meet the objectives of this study was the following:

1. Estimate the different salary levels of countries in Eastern and Western Europe.
2. Estimate changes to the differences in salary levels in coming years.
3. Estimate the cost of salary compensation to be paid as part of the delocalisation decision, based on the information from an industrial sector for which delocalisation is a current problem.
4. Determine the continuous improvement rate necessary to prevent company delocalisation. The continuous improvement rate necessary to prevent delocalisation has been calculated on the basis that the benefits of continuous improvement will be higher than the profits that might be generated by transferring the company’s operations to an economic region with lower salary costs.

What must be determined is the differential rate of continuous improvement for a company’s plant threatened with delocalisation; the benefits of continuous improvement must equal the savings generated in one plant with respect to other plants of the same company. In accordance with this outline, each time a plant generates a saving in respect to other plants of the same company, this benefit is retained for two years before being transferred in line with the imperatives of multinational company management strategy. At the same time, the benefits of company delocalisation are calculated as the savings in salary costs for each year minus the compensation costs incurred in the decision to delocalise operations. These strategies are considered in the context of a 15-year period; the values used in calculations are current values with a rate of real decrease of 10%.

**Results**

The following results were obtained from the analysis of the information outlined above:

1. Continuous improvement is a way by which one plant can gain an advantage over other production plants of the same company in internal competition. The challenge for each plant is not only to sell more products to a higher number of end consumers, but also to be competitive within the company as a whole.
(The fact that all company plants produces the same product(s) using the same production processes and with the same brand and product guarantees should be born in mind.) Differences in salary costs may be compensated by reductions in the overall plant costs. Overall cost reduction levels vary depending on the countries compared: a plant in France should operate at a 0.82% lower annually rate cost than a plant in the Czech Republic, but the difference rises as high as 3.17% in a comparison between plants in Germany and Poland. Many decisions to delocalise company operations might be prevented by the achievement of an annual rate of continuous improvement of 1%, provided that this rate is sustained. From the information presented in Table 1, it is clear that differences in salary costs will continue to decline and that such differences will become negligible within the next 15 years.

Table 1: Rate of Continuous Improvement.

<table>
<thead>
<tr>
<th>Country</th>
<th>Czech Rep.</th>
<th>Poland</th>
</tr>
</thead>
<tbody>
<tr>
<td>Spain</td>
<td>1.05</td>
<td>1.36</td>
</tr>
<tr>
<td>Portugal</td>
<td>1.06</td>
<td>1.76</td>
</tr>
<tr>
<td>Germany</td>
<td>2.77</td>
<td>3.17</td>
</tr>
<tr>
<td>France</td>
<td>0.82</td>
<td>1.03</td>
</tr>
<tr>
<td>Italy</td>
<td>1.96</td>
<td>2.38</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>1.09</td>
<td>1.29</td>
</tr>
</tbody>
</table>

2. The continuous improvement rate must be sustained over time if it is to be a valuable asset to the production plant in internal competition.
3. In order to ensure that it is sustained, continuous improvement objectives must be included in the company’s management strategy, which gives rise as a result of a work-place culture that brings together the interests of all the ones involved in the plant’s operations.
4. Given that global markets operate within the European Union and that there no longer exist economic borders between many countries, the stability of employment at a multinational company production plant is under constant threat. This situation poses a particular strategic problem for company plants: they can no longer compete by traditional means and must look to new ways of gaining competitive advantage in internal competition. Trade unions, in particular, must take this new situation on board and do everything in their power to guarantee employment and job stability to ensure that plant operations also remain profitable for company management and shareholders.
5. Decisions to delocalise are prompted when the conditions of entry to and exit from markets are propitious. Given the recent enlargement of the European Union, many companies have taken the decision to delocalise their operations. In order to prevent delocalisation, companies must produce valuable results in the immediate short term. Given that differences in salary costs will continue to decline, and compensation costs continue to rise, any delay in the decision to delocalise makes delocalisation less likely.

Conclusions

The conclusion to be drawn from the research carried out for this article is that a company strategy based on a policy of continuous improvement guarantees good economic results in the medium term because it foments competition and employment stability in globalise markets.

Internal competition should be driven by company functioning that facilitates reductions in overall costs at production plants – that is, by continuous improvement in the management system, production processes and products. In order to achieve this goal, plant management should strive to win the support of employees and suppliers because their contribution to continuous improvement projects is vital. Production plants should develop abilities and functions, which cannot, delocalised them easily, such as, for example, a positive learning curve among employees and a competitive ability to improve processes and products more quickly than other production plants of the company.

The achievement of a differential rate of continuous improvement of 1% is a realistic objective, but requires a considerable effort, commitment and the co-operation of all those involved in the production plant’s operations. The combined efforts of workers at all levels in the production plant make the realisation of this difficult goal possible, and their co-operation is indispensable if delocalisation wants to be avoided.
To clarify one final point: the factors that best explain differences in profitability between companies are those related to the type of business which they belong to, not those related to the market in general or specific characteristics of the companies themselves (Rumelt, R. P. (1991)). Companies who adopt a strategy of continuous improvement can gain a competitive edge, but the success of this strategy depends on the company’s ability to renegotiate the traditional relationship between work and capital in order to develop bonds of mutual trust and co-operation.

Advanced management strategies, which are necessary to insure the achievement of a sufficient rate of continuous improvement, encourage the participation of all company employees. The goal of these strategies is, on the one hand, to strengthen employee loyalty to the company and, on the other, to increase employees job satisfaction. Included among the policies that may improve employee commitment and satisfaction are: a team-work approach; a less hierarchical management style; the use of technology to reduce errors and failures in the production process; the introduction of auto-correction systems; rotation through work-posts; and an incentive scheme. A group of Spanish companies has come together to form a business association to promote the implementation of these advanced management strategies, a development which gives cause for hope that some companies will achieve the differential rates of continuous improvement necessary to ensure that production plant operations remain profitable.

Company management must consolidate strategies for continuous improvement by encouraging the full participation of all employees and introducing improvements to the work-place dynamic. At the same time, the management and evaluation of continuous improvement strategies must take into account the existence and value of internal competition, ensuring that profitable improvements introduced at one plant are not standardised throughout the company without the original plant receiving any reward for its commitment and effort. Appropriate management and evaluation means that the company should reward employees for their co-operation in the strategy of continuous improvement and share the profits generated by such improvement directly with them.

Future studies in this field should address the need to provide objective evaluations of the ability of production plants located in developed countries to improve at a more competitive rate than plants based in economic regions with lower salary costs, and the need to measure the effects of a strategy of continuous improvement on employee commitment and satisfaction, in the work-place culture and dynamic.

References