

monthly innovation insight

Welcome to the first briefing of 2009 which, in these challenging times, takes a look at the current options for the Big 3 US automakers:

Innovation Briefing: *Invest in Success, Not Survival*

Pity the US taxpayer. As auto manufacturers and their finance arms receive multiple rounds of bailouts, as with the banks, the government is becoming a major shareholder of the Big Three. These bailout deals were declared a "necessary evil" and a "victory" for workers with "punishment for management." Nevertheless, doubts about these companies long term prospect and workers' job security remain unchanged.

The Big Three need the capital but not for the reasons described in the business press. The truth is the US auto industry is not failing. Rather, US manufacturers are falling short. About one quarter of cars sold in the US are produced by Toyota, Honda and Nissan, but you won't see them lining up in Washington for handouts. Why? Because their business models are different than their US counterparts in ways that matter to customers. It's likely a majority of those reading this article are now thinking "yes, that's right, I don't drive a Buick".

Want to get angry about it? Ring up your representative and demand that if they must infuse your tax money to Detroit, then we should extract something much more important than equity in return. We should not spend taxpayers hard earned dollars only to extend the lives of dying enterprises; instead, we should invest in sustainable businesses that will provide more and better quality jobs. To get this, we must demand innovation, real business model innovation.

Management gurus from Gary Hamel to Clay Christensen tout the criticality of business model innovation, the way a company structures its key components to deliver values and extract profits. Analyses by the Boston Consulting Group, Business Week and Innovaro all demonstrate that business model innovators create more value for shareholders than those who compete instead on mere product or cost-based innovation alone.

Despite the fact that analysts have declared, for decades, US automakers' business model is troubled, the Big Three have fallen short in most every way in revamping their way of doing business - other than recent efforts to offload their pension liabilities. Even that was the brainchild of private equity investors. So, now we have this terrible crisis with very real human and capital costs.

The truth is that US automakers ignored many opportunities of business model innovation. One noted example: the approach for manufacturing low cost mass market automobiles for developing economies. About ten years ago, a business development team of one of the automakers uncovered a small "garage" business that was able to build cars in a shed behind their house. The design was based on tubes that could be bonded together - the entire vehicle was provided in kit form. So, instead of erecting a traditional high capital automobile manufacturing plant or shipping cars across the ocean, this automaker could have constructed a business model with component suppliers and small scale local assemblers. Instead, it was and is more of the same with a failed attempt to "de-contented" one of its lower-priced cars by stripping out as much as it could. The result: an unappealing car that was still too expensive for the market. Instead, a few years later, India based competitor Tata has introduced the Nano - a potentially globally disruptive affordable car with a business model featuring its manufacturing process, and the overall supply network all designed for serving developing economies' mass markets.

The Nano is but one example of business model innovation. On the high end of the market - think Lexus. Who under forty would not rate it as a premium car brand? And, twenty-five years ago, who would have thought it possible for Toyota to make automobiles that now stand as a statement of luxury?

Unfortunately, the Big Three's current crisis did not emerge overnight - they have been losing market shares steadily and struggling for profitability for decades. Although the housing bust and credit crunch dramatically clamped down consumer and business spending at all levels, every automaker saw a significant drop in sales. So, the current economic crisis wasn't the driver of the Big Three's demise; it was a catalyst that accelerated their implosions.

It is not as if the US is the first economy to encounter this - take a look at the UK for example: Thirty years ago the established auto-manufacturers were surviving on government subsidies. Twenty years ago these were all taken away and a more competitive environment was introduced - one which attracted Honda, Nissan and Toyota to establish major research and manufacturing facilities in the UK, provided the opportunity for VW and BMW to make significant investments in the Bentley, Rolls-Royce and Mini brands and more recently prompted Tata to acquire Land Rover and Jaguar. Nevertheless, UK's strength in automotive engineering continued as the majority of F1 cars and engines now designed and made in the Oxfordshire area - a major center of European automotive excellence.

Today in the US, with extinction a real possibility, the Big Three are pleading for help. Given the political sentiment and labor union lobbyist pressure, the new administration may have little choice but to respond. But rather than wasting cash on propping up an outdated and out of touch sector, shouldn't we be using it to support the innovators that will take the industry forward. So, get angry. And maybe, just maybe this one time, we might see some business model innovation from Detroit.

This article is authored by Peter Skarzynski, founder and CEO, and George Chen, Director, at Strategos, a division UTEK Corporation.

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