

ONLINE EXCLUSIVE: Happy Anniversary, Honda

By Patricia E. Moody

Veteran former Honda executive Dave Nelson explains why Honda consistently delivers high profit margins. As senior vice president, Nelson was the first American on the Honda of America Board of Directors. At Honda, purchasing is a strategic function and during the last three years of his tenure as head of purchasing, the vice presidents of Finance, HR, Corporate Communications, Government Relations and Legal reported to him for a total combined spend of \$8 billion.



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Today, direct purchases alone in North America, including the new plant under construction for the Fit sub-compact vehicle, plus two factories located about 150 miles east, add up to about \$16 billion, with total costs at \$20 billion. In addition to purchasing for Honda's American plants, Nelson was project leader for the \$1.2 billion a year, two-door Civic start-up in Thailand.

Good News for American Manufacturing

As soon as the new Fit plant in Mexico is complete, there will be 33,000 Honda Associates in North America. The new facility, which cost \$800 million, will boost Honda's capital investment in North America to \$21 billion. Ohio, Nelson said, is making a variety of other plant and equipment investments totaling more than \$500 million. By spring of 2014, production capacity in North America is projected to reach 1.87 million vehicles. This is where Nelson's strategic sourcing interests

are piqued. "More than 85 percent of the vehicles sold in North America are manufactured in North America," he said. "In fact, Honda will soon be building the Acura NSX super sports car, plus other Acura models and Accords, Civics, CRVs, Hybrids, as well as the small Fit. So the whole range of vehicle products will be built in North America."

Shocking Statistic

This is good news for suppliers in The Americas. Numbers don't lie. Honda of America (Canada, Mexico and U.S. plants) has more than 600 direct suppliers making up the 1.87 million vehicles. This is another overt clue as to why Honda's profit margins are driven by strategic sourcing. How unusual does it seem among giant corporations to find 600 direct (parts, assemblies, raw, etc.) suppliers responsible for \$16 billion in vehicle sales? We're talking about hundreds of suppliers, not thousands.

Nelson reinforced these numbers, "There are two main reasons why Honda is as competitive and as profitable as they are. One is the Honda Philosophy that empowers all employees as mentioned in the *Industry Week's* lead feature celebrating Honda's 30th anniversary."

The other reason is the inclusive relationships with their strategic suppliers in which the suppliers are considered extensions of Honda. In-house costs are about 25 percent of the vehicle's cost, while outside purchased costs represent 75 percent. This means that both Honda associates and Honda suppliers are what make this automotive company so competitive. Honda's strategic suppliers provide more than 90 percent of the cost of the parts that Honda buys.

Strategic Supplier

The following is Nelson's partial list of requirements to become a Honda strategic supplier:

1. To have an open book arrangement with Honda in which Honda Purchasing has access to all of the supplier's financials. "This means,"

Nelson said, "that Honda purchasing has access to all of the records of the supplier, including what they pay for their raw materials, how much they pay their workers, what their profits are and basically a total open book to all the company's records. The supplier agrees to sell the parts to Honda at those cost standards."

This open book concept was shocking when first introduced to suppliers who were producing for "The Big Three" in Detroit. But eventually, as information technology has enabled more accurate costing approaches, open book has lost much of its fear factor.

"The Honda buyers often know more accurately what the supplier's parts cost are than the suppliers do," he said. "If, on a rare occasion, the Honda buyer makes a mistake, and after the supplier starts making the parts, he feels the price Honda set is too low, the supplier advises Honda. Honda immediately sends a BP (the Honda production system featured in the book *Powered by Honda* by Nelson, Mayo and Moody) Engineer to the supplier. If that engineer cannot arrange the manufacturing process to make the parts for what the Honda buyer set, Honda will change the price to the correct level.

According to Nelson, this is a rare occurrence. "While I was VP, about 300 new models of vehicles, engines, transmissions and various assemblies were introduced. Not one time were the target costs set at the beginning of the product development cycle ever exceeded, nor did we ever miss a production start (SOP) date. Honda Purchasing, Honda engineers and the supplier's engineers work as a team to achieve the target costs and SOP date, often set three years before the start of production. Once the products are in production, ongoing continuous improvements made by suppliers that reduce cost are shared with the supplier, significantly improving their margins."

2. To agree to welcome Honda's BP teams (lean supplier development teams) to help optimize manufacturing and business processes.
3. To agree to participate in Honda training, as necessary. Corporate training programs include leadership, finance and how to create effective employee suggestion systems. Training programs also include how to develop Quality Circles in which a small team works together using a formal process to improve the process. the tooling, the machine lay out and a variety of ways to make numerous improvements to the manufacturing and business processes.
4. To agree to a top management business meeting once a year where a) the goals and results of the previous year are reviewed; b) the current year-to-date goals and results are reviewed; and c) the next three years' goals are reviewed. About 50 elements are reviewed in a formal setting.
5. Agree to develop new models from the earliest development stages together with Honda engineers, giving multiple suggestions on how to improve the parts functionally and improve costs compared to the previous models.
6. To be 100-percent quality and 100-percent delivery, because to shut down a line for lack of parts costs Honda out of pocket costs of many thousands of dollars per minute. (Note: Outside estimates for line-down situations at the time of *Powered by Honda* publication stood at \$26,000 per minute.)
7. To practice continuous improvement in all of their manufacturing and business processes.

In return for agreement to partner with Honda on these requirements, Honda would commit to maintain them as a supplier and award them new business as it becomes available. "Almost 100 percent of the original suppliers selected in late 1980s are still Honda suppliers today," Nelson said.

Honda's Impact

Fortunately for supply management and manufacturing professions, the visibility, responsibility, power and IT tools used to manage global supply networks have risen in the 30 years since Honda's arrival in the Americas.

For Nelson, heading up procurement was an especially positive challenge. "For me, the biggest reward has been watching my direct reports over the years become the EVP, SVP and VPs of supply management in more than 20 majors, including Whirlpool, Nissan, Rolls-Royce Airplane Engine, Eaton Corp, Cardinal Health, Sara Lee, Bank of America, Delta Airlines, Takata, University of Chicago Medical Center, Kohler, Harley Davidson and others as well as TRW, Honda of America, Honda Worldwide, Deere and Delphi. We've come a long way."

Named a "Pioneering Woman in Manufacturing" by *Fortune* magazine, Patricia E. Moody is a business visionary and author of 14 business books and hundreds of features. She has been a manufacturing and supply management consultant for more than 30 years. Her client list includes Fortune 100 companies as well as startups. Moody is the publisher of *Blue Heron Journal*. She created the *Made In The Americas* and the *Education for Innovation Series*. Her next book about the future of manufacturing is called *The Third Industrial Revolution*.