

Cost problem of captives: CMS strategy is a decisive building block for international cost optimization!

CONSISTENTLY STRONG GROWTH: IMPORTANCE OF AUTOMOTIVE CAPTIVES CONTINUES TO INCREASE

The captive business with its leasing and financing products has grown steadily over the past ten years. The captives of the leading German automakers are racing from one record to the next - on average, their EBIT has grown by 6% annually over the past 10 years.

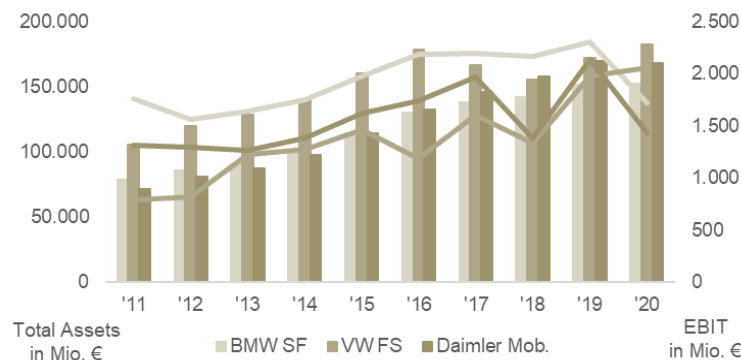


Figure 1: Total assets (bars) and EBIT (lines) 2011-2020*

Trends toward subscription and all-inclusive models are a sign that the captive market will continue to grow in the coming years. All this means that captives are becoming increasingly important in their group families. In fiscal year 2020, the three major German captives contributed an average of 26% to the Group's respective earnings.

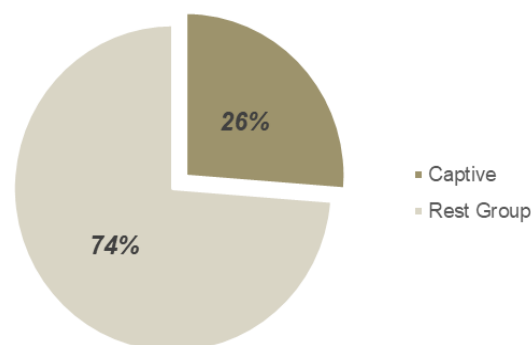


Figure 2: Captive share of Group EBIT 2020*

Increasing importance is naturally accompanied by increased expectations of future earnings contributions. In the future, the management boards of large corporations will therefore pay even closer attention to their captives and their development.

* Source: Annual reports Volkswagen Financial Services AG, Volkswagen Group, Volkswagen Bank GmbH, BMW Group, Daimler AG 2011-2020

WITH EACH NEW CONTRACT THE PROFIT MARGIN DECREASES DUE TO COSTS INCREASING STRONGER THAN REVENUES

In addition to an increase in the contract portfolio, the captives' financial reports also reveal a decline in operating profit per contract. In times of constantly low interest rates, the lever for profit per contract are the marginal costs. However, these have risen in recent years or are moving sideways. Sustainable EBIT growth can only be achieved by reducing marginal costs.

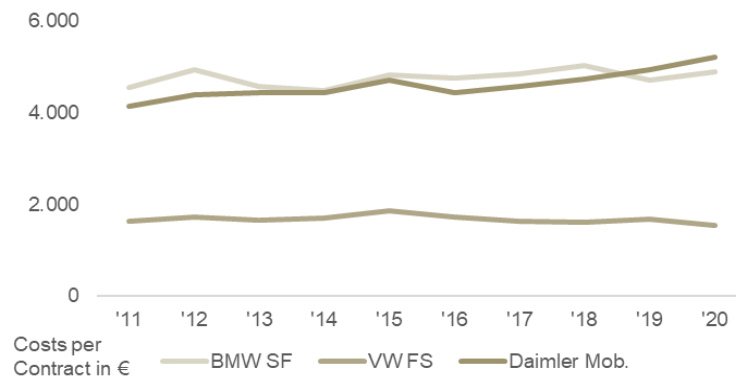


Figure 3: Total costs per contract** (lines) 2011-2020*

FOCUS ON PERSONNEL AND MATERIAL COSTS AS DIRECTLY CONTROLABLE LEVERS

Around 90% are driven by interest, leasing and commission expenses as well as risk provisioning. These costs are largely caused by external factors, i.e., factors that cannot be influenced or can only be influenced indirectly and affect all institutions equally.

Interesting levers are personnel and material costs, which account for only 10% of a captive's total costs but are determined by internal factors. Assuming the average costs of a captive amount to around EUR 25 billion, personnel and material costs are a non-negligible amount at around EUR 2.5 billion. A 5% reduction in personnel and material costs would equal savings of EUR 125 million p.a. With average revenues of around EUR 30 billion, this corresponds to a sustainable overall improvement in earnings of 2.5% per year.

But what are the main factors determining these costs and what options are available to provide noticeable relief? Important factors include the complexity of captive processes and the unnecessary number of (system) breaks along these processes (keyword: personnel deployment). Many IT systems required for process execution also indicates high IT costs, thus material costs.

INDUSTRY AS A ROLE MODEL? PRODUCTION OF CAPTIVES TODAY STILL MORE MANUFACTORY THAN ASSEMBLY LINE

In industry, as in the financial services sector, it is the products that make the difference. But one thing quickly stands out: The complexity of captive products is low compared to large international banks, which suggests that the associated processes can (and must) be designed efficiently.

** Number of contracts taken from annual reports

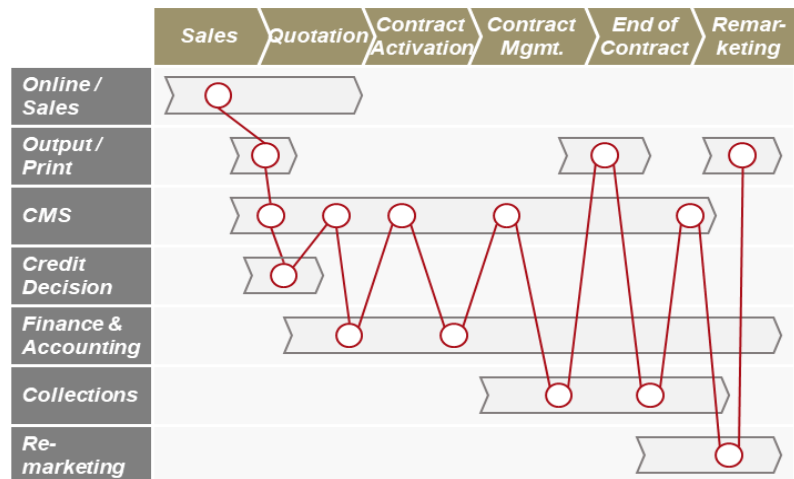


Figure 4: Illustrative leasing process Captive (status quo)

What is surprising, however, is the actual complexity found in many captives across all leasing and financing processes. Unlike their corporate parent companies, which have optimized their production processes to the limits of the possible over many decades, many captives "afford" historically grown, inefficient and technologically suboptimal supported processes. This picture is only worsened by the fact that processes and systems of the captives are individually designed in almost all the numerous market subsidiaries but are therefore no more efficient than in the home market.

In our opinion, this is the reason for a large part of the obvious material and personnel cost problem. Internationally operating captives urgently need to modernize their production facilities and lines to be able to reduce costs sustainably.

CONTRACT MANAGEMENT SYSTEMS ARE THE DRIVING ELEMENT OF AN EFFICIENT PRODUCTION LINE!

Unlike the modern manufacturing plants and giga-factories of our time, the "production" of a captive is something much more abstract, harder to grasp. It does not "produce" tangible goods but leasing and financing contracts.

Nevertheless, the comparison with the industry is worthwhile: The efficiency of captive production is also determined by its facilities, thus the number and technological maturity of the IT systems used as well as by "production lines," and the optimal arrangement of individual process steps along the overall process.

Management of all contracts, the heart of a captive's "production line," is done in the CMS. Consequently, this system must be the focus of a sustainable strategy for process and IT (material) cost optimization and thus for increasing profitability.

PERSONNEL AND MATERIAL COSTS CAN BE SIGNIFICANTLY REDUCED THROUGH CMS MODERNIZATION

On the one hand, a new contract management system can optimize processes, and on the other hand, it can also make many the systems required today redundant and therefore switched off.

Work steps that are currently performed manually and along various system breaks can be optimized through automation and greater coverage of functionalities. By reducing manual work steps and system breaks, the necessary personnel deployment can already be significantly reduced.

Modern contract management systems can do much more than just managing contracts. The example of Collections illustrates that modern CMSs cover functions that are still carried out in separate systems in many cases. Thus, the CMS implementation can "replace" a crucial conversion system, with a noticeable reduction in personnel and material costs.

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NUMEROUS ATTEMPTS OF AN INTERNATIONAL CMS STRATEGY HAVE FAILED – BUT WHAT IS THE REASON?

So far, no real success stories have been observed when it comes to the strategic renewal of the CMS solutions of the captive national companies. In some cases, large-scale CMS standardization and rollout projects were launched, but in almost all cases they were aborted without success. After that, system rollouts were mostly tactical, driven by constraints in individual markets. Thus, tailor-made solutions are created wherever outdated systems force action.

We have observed projects that, after a long and complex development of a supposedly global standard, already failed during the first market implementation due to local specifics. The laboriously defined standard was given up. Other CMS implementations were overloaded step by step with requirements and integration complexity, until budgets and runtimes made the initial goal obsolete. Sunk costs instead of noticeable cost reductions were the result. But how can both scenarios be prevented and potentials be fully realized?

A clear concept and a professional and technical standardization approach are mandatory. This must both promote synergies and process improvement and not hinder differentiation in national competition. Without such a strategy and an exemplary philosophy that can initiate and consolidate rethinking within the organization, successful CMS strategies will remain to be the exception.

EFFECT ONLY POSSIBLE IF AN OVERALL INTERNATIONAL CMS STRATEGY IS PURSUED

Together with our customers, we have developed an approach that takes a holistic view of the introduction and modernization of contract management systems and achieves standardization through reuse. In this way, cost reduction potentials are realized and competitiveness is ensured at the same time.

For this purpose, the systems must already be evaluated along the decisive topics during the selection process. Particularly in functional topics, such as accounting or business intelligence solutions, as well as in technical topics, such as integration and software stack, the offerings of the systems differ significantly.

During the actual implementation, adjustments to the system must be reduced to what is necessary in order to keep project costs low and, on the other hand, to exploit the potential of purchased software (keyword: standard). The "reversal of the burden of proof" ensures that individual requirements are only implemented if they are based on (local) regulation or have a positive business case (keyword: competitiveness).

To reduce material and personnel costs noticeably, this approach must be applied to as many national companies as possible, whereby international business models make it difficult to standardize processes and products across countries. This is precisely where reuse and reversal of the burden of proof act as a necessary catalyst. Regional differences in customer behavior and in the products offered are closely monitored and ultimately their business value determines whether they are considered.



Figure 5: "Copy & Paste" with reuse approach

Such a CMS renewal must be understood as a strategic top management task and implemented with the appropriate resilience. For companies characterized by decentralization and market autonomy, clear and strict rules must be provided from the headquarters. In most cases, even control mechanisms and target systems in management must be reconsidered and adapted. To do this, however, it is always necessary to turn those affected into participants, to sensitize them to the urgently needed paradigm shift.

We have been successfully supporting national and international CMS implementation projects in the captive sector for years. Together with our clients, we develop strategies and rollout approaches that use the modernization momentum to solve structural cost and efficiency problems. We take a holistic view of the CMS strategy, from its definition and anchoring in top management to software selection and commissioning.