Cost Management Practices :

Hero MotoCorp : 2011-12

The case of Hero Motocorp has been taken for the best practice in cost management. For this purpose, the cost management effected in major components of cost with certain parameters and the impact on profitability have been analysed as detailed below :

PROFITABILITY :

- EBITDA margins increased to 15.35% up from 13.47% (previous year)

Reason : Discontinuation of royalty payments on some models.

- Operating Profit increased from 2210 crores to 2521 crores.
- Despite healthy growth in sales, Operating Margin decelerated from 11.39% to 10.69%

Reason : Higher input costs for raw materials and components.

Cost Management :

RAW MATERIAL COSTS

- Rise in Raw material costs as a proportion of sales, shot up from 73.3% last year to 74.0% during the year, adversely impacting EBITDA margins

Cause : Hardening of metal prices during the year particularly steel, copper, aluminium and nickel

Cost optimisation through SCM :

Strategy and action :

1) As the Company prepares to produce a wider range

of products, efforts are being taken to align the supply chain and prime up its supplier base. During the year, the Company kick-started the process of migrating its existing brands to the new brand. The exercise is expected to be completed during 2012-13.

2) During the year, the Company also commenced the process of working with its vendors to develop new parts. The Company's SCM function is built on three planks:

- **Cost**
- Quality
- Sustainability

Action :

1) Tracking inventory cost effectively and efficiently is known to be a key source of competitive advantage in the automobile industry. Hence, **Cost Leadership** is the Company's prime focus area.

2) Finding innovative and alternate ways to combat inflation due to continual pressure on margins.

3) Considerable attention was given to managing component inventory in the system, with double-digit growth in inventory turnover.

OPERATION RAMP-UP

- As the demand for bikes recording a stupendous growth of 15% during the year under review, the Company's capacities were severely strained. This prompted it to augment its capacity at its three plants – up from 5.4 million units to 6.35 million – during the year.

- This was made possible through a number of de-bottlenecking measures. (e.g) the Company's plants were made leaner by outsourcing non-critical processes and operations.

- A number of structural changes and alterations were made in its manufacturing strategy to effectively implement its Sales Plan for 2012-13.

- Major replacements were also executed in the paint and assembly shop, ensuring little or no shutdown along the assembly line.

❖ Several innovative technologies were inculcated to reduce operational costs.

Examples are:

- A breakthrough technology for gear rolling was implemented for mass-production.
- Fine blanking, an alternate process of hobbling, was introduced for sprocket components
- Advanced cam grinding was introduced to increase productivity and control costs

- The Company's oldest plant at Dharuhera was in the limelight for two specific reasons:

1) Wage negotiations were concluded
2) Plant won TPM Excellence Award

Energy Conservation :

The Company continues to set new industry benchmarks in the areas of energy conservation and sustainability.

a) Vapour absorption machines and heat recovery units were installed during the year to utilise waste heat from Gas DGs for air-conditioning and pre-heating of hot water generation.

b) Other green initiatives included projects on waste water management, LED lighting and solar power.

These cost leadership and green projects yielded considerable savings to the Company within a short period of time.

IMPACT OF MEASURES AT a) AND b) FOR REDUCTION OF ENERGY CONSUMPTION AND CONSEQUENT IMPACT ON THE COST OF PRODUCTION OF GOODS

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DEBT STRUCTURE AND FINANCE COST :

Hero MotoCorp has been a debt-free Company for the past eleven years and incurs no borrowing costs. Finance cost includes interest on account of advances from dealers and other transactional costs.

Hero MotoCorp : 2012-13

Profitability:

- The Company's earnings before interest, depreciation and taxes (EBITDA) margins decreased from 15.35% in 2011-12 to 13.82% in 2012-13.

- Operating margins fell from 10.69% to 9.02% on account of higher input costs and amortisation.

- Operating profit (PBT before other income) decreased from ` 2,521 crores in 2011-12 to ` 2,143 crores in 2012-13.

Decline in sales caused the margins to fall.

Debt structure:

- Hero MotoCorp is debt-free for the past 12 years and incurs no borrowing costs.
- Finance cost includes interest on account of advances from dealers and other transactional costs.

Customer at the Core:

Customer satisfaction is at the heart of Hero MotoCorp's business strategy. SAP data shows a secular decline in the number of customer complaints over the last three years, but the journey to enchant the customer through better products and services continues.

The voice of the customer is captured and amplified constantly through a 360 degree feedback mechanism that includes customer satisfaction surveys, online customer feedback, response from visiting field executives and market quality surveys.
The Company's approach to customers is based on the principles of increasing accessibility, facilitating product upgradability, guaranteeing low cost of ownership and ensuring continuous customer engagement.

Seamless Supply Chain:

During the year, it was also possible to execute a sharp ramp-up of Maestro parts capacity at the suppliers end to cater to increased demand for this particular scooter brand. Supplier capabilities were also quickly upgraded to cater to the production of newly launched models - Ignitor and Passion Xpro.

Hero MotoCorp initiated over 50 quality improvement projects with the supply chain partners to ensure better quality products. To tackle the increasing cost pressure on Hero MotoCorp as well as on suppliers, a new department called 'Achieving Cost Excellence' (ACE) has been set up to optimise cost performance.

To ensure business growth and continuity by facilitating people process development at associate organisations of Hero MotoCorp, a Supply Chain HR IR initiative, under the consultation of AON Hewitt & Ernst & Young was successfully implemented last year.

The project is now close to completion, and is expected to result in significant benefits, in terms of de-risking these organisations from IR issues.

During the year, the sixth batch of participants were enrolled into Hero MotoCorp's Green Vendor Development Programme. The programme has enrolled 130 vendors till date. Over the coming months and years, Hero MotoCorp's supply chain will have to be aligned to keep pace with new products rolling out from factory premises. As these products will be technologically superior, suppliers will be required to raise the bar of competence as well. The Company is also gearing to play a more significant role in developing new and existing suppliers.

R&D outlook:

R&D’s focus in the coming months will rest on four key planks: on refurnishing existing platforms, on developing products with alternate fuel options, on compliance with stringent safety and environment norms and finally, on achieving cost competitiveness through VA/VE and innovative cost reduction ideas.

Meanwhile, work on designing a world-class Technology & Integrated R&D Centre at Kukas, Jaipur has been completed. It will be India’s largest integrated Two Wheeler Technology centre. It will have innovation labs for component design, engine and vehicle testing. These will use the latest software for collaborative design and vehicle simulation.

Besides high-tech equipment, the Centre will also have an entire range of test tracks to enable R&D for self sufficiency. This Technology Centre will be the fulcrum from where our future products will uncoil and spring.

INTEREST RATES:

The Company has not been significantly affected by the higher interest rate scenario owing to a strong balance sheet and healthy cash flows. However, in the event of significant expansions being planned by the Company, rising interest rates can increase the cost of capital and also impact the operations of crucial vendors. To counter this challenge, the Company is pursuing an aggressive policy of multiple sourcing.