

# Strategic Report for Ford Motor Company



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## Executive Summary

Ford Motor Company faces many strategic challenges during these volatile economic times. In the next month and a half, two of its major competitors may be forced to file for bankruptcy or liquidate assets. As of this writing, Ford is the most financially sound American car manufacturer and possesses enough cash on hand to continue operations through fiscal year 2009, provided there are no further dramatic deteriorations in the market. Analysts believe that the company will not need to seek government funding unless car sales for 2010 are below 12 million. While Ford, like all major car companies at this time, faces serious challenges, we assert that opportunities exist during any time of crisis. We believe that Ford can, with our help, break even in fiscal year 2010 barring further macroeconomic deterioration.

This report makes the following recommendations to Ford Motor Company:

- 1) Ford should continue attempts to sell off the Volvo brand. The funds from this sale should provide Ford with increased flexibility during the coming year as well as contribute to existing strategic goals.
- 2) Ford should extensively prepare for the bankruptcy of Chrysler and/or General Motors. Such bankruptcies pose a great deal of risk to Ford, including but not limited to: the possibility that the government may chose a winner, the potential for GM to emerge from bankruptcy with a significant cost advantage, and supply chain disruption resulting from bankruptcies of mutual suppliers. While we believe that any liquidation of Chrysler should be viewed as a strategic opportunity, we remain deeply concerned about how the future of GM may impact Ford. In the short term, we believe that Ford should continue to capitalize on its competitors' instability and steal market share.
- 3) We have faith in management's 'One Ford' strategy and believe that the Ford Fiesta is poised for success in North America, if marketed correctly and executed properly. Continued differentiation through the creation of defining style and feature set exclusive to Ford vehicles is also a positive step in the long run.

- 4) We recommend that, wherever possible, Ford should shift production from the United States and the Euro Zone to Mexico and Eastern Europe.
- 5) We recommend that Ford exploit current opportunities in China and apply capital to ramp up its sales and market share. In the long run, Ford must also focus on expanding its share in India. We do not, however, recommend that Ford invest significant capital in the Indian market at this time.

We at Oasis Consulting believe that these recommendations are in line with the Ford philosophy and are in touch with its history as a family owned company. *It is important to note that this report is only current as of April 20<sup>th</sup>, 2009.* Industry circumstances are rapidly changing, and Ford's optimal next steps cannot be fully expounded upon until specific information regarding GM and Chrysler's future is announced. Oasis Consulting looks forward to the opportunity to provide continued support for Ford Motor Company as the situation with Chrysler and General Motors develops, and believe that this report sets forward the optimal strategy for the company at this juncture in time.

## Company Overview

### History

Ford Motor Company was founded in 1903 by Henry Ford and has continuously remained under family ownership since this time. The company developed and implemented assembly line production by the release of the Model T in 1909, and produced planes and vehicles for the Allies in World War II. Ford has operated internationally since 1904, when it opened a branch in Canada to gain access to Commonwealth markets. For the first half of the 21<sup>st</sup> Century, Ford remained the dominant car manufacturer within the market it had effectively created. In 1956, Toyota exported its first automobile to the United States, and began acquiring market share. In hindsight this was a turning point in the U.S. market, and as the 21<sup>st</sup> Century drew to a close Ford faced declining market share and had difficulty remaining competitive in the global marketplace. Ford was particularly inhibited by substantial legacy

costs—primarily from employee pensions and healthcare benefits—and falling demand for its most profitable lines of vehicles.

In 1996 the company launched the ‘Ford 2000’ initiative to streamline supply lines and reorganize the company’s worldwide operations into a more cohesive unit. In spite of some important successes, including the popular Ford Focus model and a streamlined organizational structure, costs at Ford remained higher than most of the firm’s competitors. In 2006, Ford posted its biggest operating loss to date: \$12.6 billion. This coincided with continued deterioration in market share, with the majority of these losses being captured by Toyota and General Motors. From 1997 to 2007, Ford’s United States market share plummeted from 25% to 15%.

In 2006, Alan Mulally was hired as CEO and took over a company at the precipice of failure. Mulally announced a new restructuring plan in 2006 entitled ‘The Way Forward’, designed to “better align capacity to demand”. At its core, this plan involved the closure of seven assembly plants and strategic reorientation towards ‘One Ford’. Championed by Mulally, this strategy focuses on creating a standard Ford personality which is seen and felt within every automobile produced by the company. In addition, the plan entails standardizing chassis worldwide and a greater focus on the core Ford nameplate. As a part of this plan, Ford mortgaged all of its assets—both physical and intellectual property—in December 2006 for a \$23.4 billion line of credit. While originally seen as a risky and potentially desperate move, this timely acquisition of capital has made Ford the most stable of the Big Three carmakers. The company also divested some of its non-Ford brands during this time, selling Jaguar and Land Rover to Tata Motors for \$2.3 billion in 2008. Ford is also currently attempting to sell Volvo, which it purchased in 1999 for \$6.5 billion.

## **Business Model and Market Overview**

Ford Motor Company currently employs approximately 213,000 workers worldwide and markets vehicles under four primary brands: Ford, Lincoln, Mercury, and Volvo. The firm is divided into two departments, Automotive and Financial Services. Ford Credit offers

vehicle financing to both retail consumers and to dealers. Approximately forty percent of vehicles sold by Ford, Lincoln, and Mercury dealerships within the United States were financed by Ford Credit in 2008, a number which has remained stable in the past three years. In Europe, the only other region with reported data, this figure has remained steadily around 27%. Conversely, financing for wholesale purchases by dealerships is nearly exclusively (98%) done by Ford Credit in Europe whereas in the U.S. this number is slightly below eighty percent. Ford Credit also plays a role in financing dealership purchases of real estate and other larger capital expenditures by the company and its affiliates.

Ford's automotive segment designs, manufactures, and services cars, trucks, SUVs, and vehicle parts. This sector is primarily broken down by region: North America, South America, Europe, and Asia Pacific Africa. The only exception to this regional model is Volvo, which operates as a separate subsector and manages all Volvo sales worldwide.

Ford retail sales operate under a dealership model, where dealerships sign exclusive contracts with the company to sell Ford vehicles. At the close of 2008, Ford operated nearly 3,800 dealerships within the United States. Approximately half of these dealerships sold only the Ford brand, with another quarter selling Ford, Lincoln, and Mercury.<sup>1</sup>

Production of vehicles for Ford typically takes within 20 days from point of order to shipping, meaning the firm faces little to no backlog or inventory buildup. Production is typically higher in the first two quarters to accommodate peak seasonal demand, which occurs in the spring and summer.

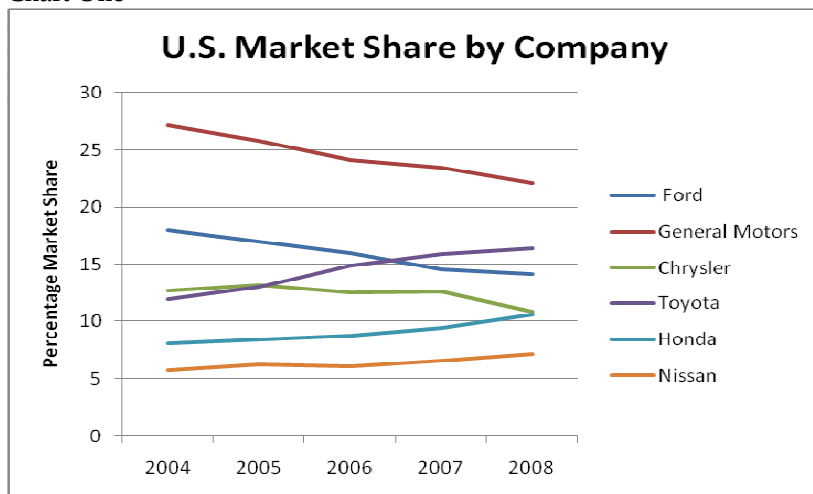
## Competitive Analysis

FORCE	STRATEGIC SIGNIFICANCE
Internal Rivalry	High
Supplier Power	High
Buyer Power	Low
Entry and Exit	High
Substitutes	Low
Complements	Medium

### Internal Rivalry

The automotive industry is noted for its intense rivalry, and within the United States market Ford faces five major competitors: GM, Toyota, Chrysler, Honda, and Nissan.

Chart One

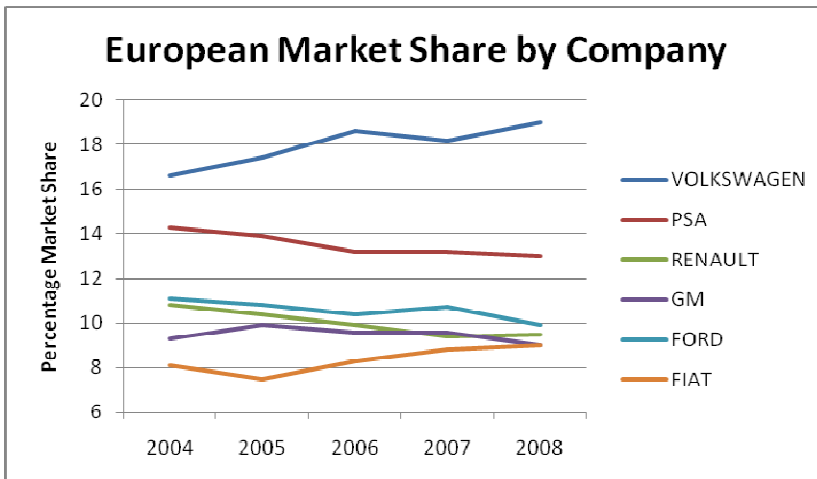


Toyota, Honda, and Nissan have grown in market share largely as a result of their ability to deliver better products at lower prices, particularly for more fuel efficient smaller vehicles. Because of lower labor costs and greater efficiency (typically measured by the number of hours needed to produce each vehicle), these companies have been able to turn a profit with smaller vehicles. In the past, Ford has differentiated itself by focusing on more profitable SUV and truck lines while often losing money on its smaller vehicles. Given changing demand, this strategy is no longer feasible. The 2008 Harbour Report found extreme differences in profit per vehicle between The Big Three (General Motors, Chrysler, and

Ford) and the foreign automobile producers within the U.S. markets. Whereas Toyota makes approximately \$922 profit per vehicle sold, estimates show that Ford lost \$1,467 per vehicle in 2008 and General Motors lost \$729.<sup>3</sup> Toyota is now the undisputed lead in vehicle production worldwide. In 2008, Toyota sold nearly nine million vehicles, compared to General Motors' 8.3 million. In recent years Toyota has not only been one of the most profitable producers, but also the most efficient: in 2008, it took an industry shortest average of 30.37 hours to produce a vehicle from start to finish.<sup>4</sup>

Within Europe, Ford's main competitors are Volkswagen, PSA (Peugeot), Renault, GM, and Fiat. Volkswagen is the dominant producer in the region, and has seen strong growth in the past four years. Ford experienced much greater success at turning a profit on small vehicles in the region, and the 'One Ford' strategy intends to take advantage of this. Overall, Ford has managed to remain competitive in Europe by designing cars which appeal to European tastes and by increasing the quality ratings of its vehicles. This has led to stable market share and profits over the past three years, and is demonstrative of Ford's ability to achieve success with smaller vehicles.

Chart Two



Note: Figures are based on new car registrations.

Because Ford has not received bailout money, it generally has more flexibility than GM and Chrysler in the current market. While there is a great deal of internal rivalry, industry upheaval appears to be imminent.

## Supplier Power

Supplier power is a significant threat to auto companies and manifests itself in several different ways. While the primary raw materials used in vehicles (metals and resins) have many suppliers around the globe, intermediate parts pose a greater problem. Currently, Ford wields significant buying power over its parts suppliers. Many parts suppliers rely on contracts with only one or two automotive firms, meaning changes in production at Ford can dramatically impact the stability of its supply chain. In the past few years Ford has made a concerted effort to reduce the number of suppliers it contracts with. Since 2004, the number of parts suppliers has fallen from 3,300 to 1,600, and the company has set a target of 750 suppliers. The goal of this process is to solidify supplier viability during difficult economic times and combat one of the biggest threats posed to Ford: the potential for failure or unexpected bankruptcy of a critical parts supplier.

The United Auto Workers Union (UAW) is the single greatest source of supplier power vis-à-vis Ford, GM, and Chrysler. This union controls the majority of the U.S. labor supply for the Big Three, which leads to higher costs per worker. Ford has been particularly successful recently in reaching cost concessions with the union, however, lowering the average wage from approximately \$70 per hour to \$55 per hour in an agreement reached in March 2009.<sup>6</sup> The largest difficulties, however, are with co-called legacy costs: retirement, benefits, and healthcare costs. In the past, these costs have been significantly higher than its international competitors such as Honda and Toyota. Ford has again been more successful than both GM and Chrysler in reducing these costs, successfully renegotiating multiple contracts by swapping equity contributions for cash infusions. In the long run, we believe that these recent negotiations may finally have turned the tide against this strategic disadvantage. Of particular importance is the structural changes which have been made regarding healthcare benefits and other legacy costs.

## Buyer Power

Retail bargaining power for automobiles is very limited throughout the world. While car dealerships negotiate with and may offer concessions to individual purchasers, the dealer—

not the automotive company—bears the costs of these concessions. Because dealers operate within a limited geographic range, they are typically not large enough to exact cost concessions from the manufacturer. In addition, dealers typically finance their purchases through Ford Credit. Overall, diseconomies of scale effectively eliminate buyer power in retail circumstances.

Fleet sales—which include purchases by large corporations, rental car companies, and the government—are the exception to this and have accounted for approximately thirty percent of Ford’s sales in the past three years. Large daily rental car companies purchase nearly three million new cars annually in the United States, for example.<sup>7</sup> Hertz was a subsidiary of Ford until it was spun off in 2005, but the two companies retain significant ties. As with all rental companies, Hertz is limiting its car purchases at this time. Outside of the federal government, which announced plans to purchase 17,600 vehicles from the Big Three in April 2009, it is likely most fleet purchasers will postpone all but the most critical orders until the economy stabilizes. This represents a shift towards more buyer power, although its impact upon revenues is difficult to extricate from the overwhelming decline in demand.

## **Entry and Exit**

Within the developed world, there are significant barriers to entry for the automobile manufacturing sector. Substantial fixed costs, the influence of brand names upon sales, and the dealership model all hinder new entrants. The ability of an entrant to gain market access—in the form of dealership space—is the most significant barrier within developed countries. In the United States and Western Europe, entry at this time effectively requires the purchase of a company with existing market access. In lesser developed countries, entry is limited by the ability to produce cars at a low enough price point to be appropriately geared for local tastes. Ford in particular has had difficulty penetrating the Indian and Chinese markets as a result of these factors in spite of joint ventures with local firms. Entry by Ford into developing markets can also be hindered by traditional protectionist measures such as tariffs and subsidies for indigenous companies.

In the United States market, exit has typically occurred through mergers and acquisitions. This may, however, change dramatically in the coming months. General Motors and Chrysler currently face large operating shortfalls, and with the rejection of GM's reorganization plan by the government in March 2009 bankruptcy is a distinct possibility. As a result of the government bailout of GM and Chrysler, any exit of the Big Three will be closely managed and influenced by the US government. A highly managed and quickly executed bankruptcy for GM is far more likely than genuine exit at this time. If Chrysler can negotiate concessions with the UAW and its bondholders by April 30<sup>th</sup>, it will likely be purchased by European company Fiat. If it cannot, the company will face liquidation.

Because of its reliance on the U.S. and European market, the entry threat to Ford in the medium run will continue to be from manufacturers with existing access to these developed markets or those who can afford to purchase or merge with such companies. The impact of exit, or government coordinated bankruptcy proceedings, is of extreme importance to Ford.

## **Substitutes**

While there are no close substitutes for automobiles as a good, recent years have demonstrated the threat public transportation may pose as an imperfect substitute. As oil supplies dwindle and fuel prices rise, public transportation becomes more feasible for communities. Furthermore, the potential for widespread investment in public transportation within the U.S. as part of a stimulus package remains a possibility. This provides an additional impetus for car manufacturers to provide highly fuel efficient vehicles for the consumer. For long distances, air travel remains the most popular and cost effective method of transport. This is unlikely to change in the near future.

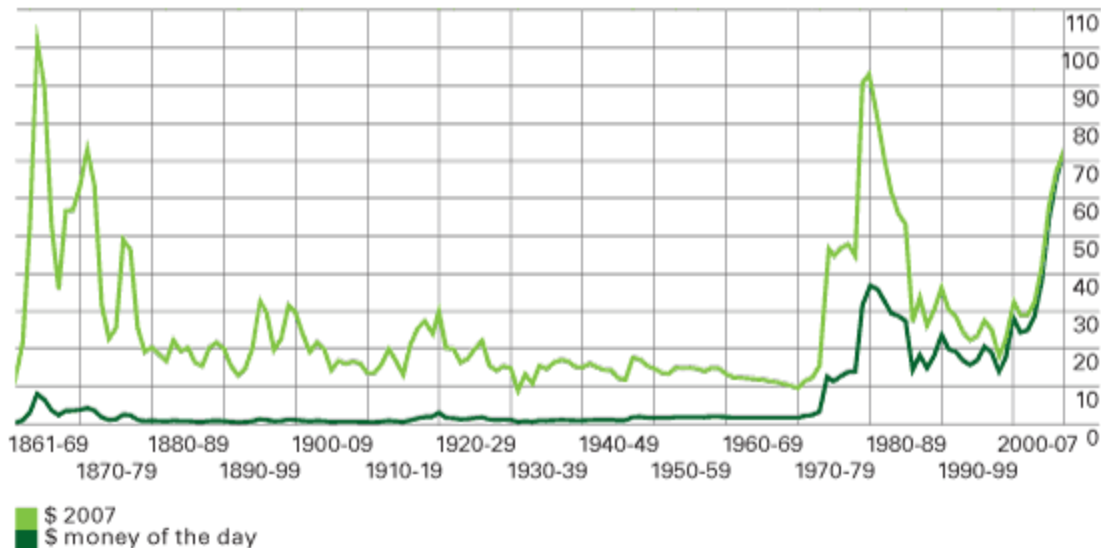
The fact remains, however, that the convenience of a car remains unsurpassed for short range transportation. The ability of manufacturers to adapt to increasing fuel prices will determine demand in the long run, but the absence of an equivalent substitute in all but the most urban environments bodes well for the future of automobiles.

## Complements

The primary complements for cars are roads and fuel. While fuel costs have recently declined, the impact of oil prices above \$100 a barrel in February of 2008 on automobile purchases was distinct. Demand shifted towards lighter, more fuel efficient vehicles. This is a significant challenge for Ford, which in recent years has profited most from its Truck and SUV lines—making only meager profits, and often losing money, from its line of smaller vehicles. Fuel efficiency considerations will continue to drive auto designs and influence demand. Ford, however belatedly, is restructuring itself to adapt to this change. Most significantly, it has begun transitioning its manufacturing plants from SUVs and trucks to cars.

Chart Three

Oil Prices per Barrel, 1861-2007



8

Within developed markets, basic infrastructure to support vehicles has existed for quite some time. In developing markets, however, the lack of functional roads can pose a significant barrier. Particularly within urban areas, where thoroughfares may be designed only for foot traffic, the need for investment in infrastructure may limit demand.

## SWOT

### Strengths

- Timely acquisition of capital makes Ford more financially sound than the other Big Three carmakers.
- Product line is respected by industry experts and is qualitatively seen to be a step above many of its competitors. Recent surveys place Ford in a tie with Toyota for greatest customer satisfaction, a significant improvement from five years ago.
- Has a global market presence, with worldwide brand recognition and a particularly strong presence in Europe.
- Is perceived to be a thoroughly “American” brand, which helps Ford among certain groups of consumers.
- U.S. market share, after years of decline, has stabilized in recent years.
- The Ford F-series pickup remains the most respected commercial truck available; despite demand shifts, profitability on this line should remain high.
- Ford has had great success, particularly when compared to its competitors, at renegotiating labor contracts with the UAW.

### Weaknesses

- Poor Profitability: Ford still loses money on many automobile lines, particularly within the United States.
- Importance of single components source (Visteon).
- The automotive market is highly competitive with large fixed costs. In addition, the market demands continual long term planning and research and development.
- Very little market penetration within China and India.
- Global excess capacity for the automobile industry is estimated to average 30.5 million vehicles per year from 2009-2011.<sup>9</sup>
- Ford is selling a durable good during the most severe economic downturn in recent history.

## Opportunities

- Ford has recognized the importance of small, fuel efficient vehicles and is actively transitioning into this market. Of particular interest is Ford's 'EcoBoost' technology, which the company claims will result in 20% greater fuel efficiency and 15% fewer CO2 emissions.
- The 'One Ford' vision has the chance to generate significant margin increases for Ford's smaller line of vehicles. Of particular importance is the Ford Fiesta, which was recently released in Europe and China and is slated for an early 2010 release in North America. The 'One Ford' vision appears to be a coherent strategy for Ford to adopt given its changed role within the industry.
- Ford is perceived to be the most stable 'American' car manufacturer because it has not been forced to take bailout money, leading to slight increases in market share.
- GM and Chrysler flexibility is limited by government involvement in their debt situation, putting Ford as a competitive advantage.
- In the event of a GM or Chrysler bankruptcy, Ford has placed itself in a position to steal market share—at least in the short term.

## Threats

- While not in need of a government bailout, poor financial results are straining Ford's capital. Cash burn continues unabated, and estimates indicate Ford may be forced to seek government financing by early 2010 unless sales stabilize.
- While Ford is readjusting production, truck sales are falling rapidly and Ford may not be able to shift production quickly enough to meet changing demand.
- Bankruptcy of Visteon or other parts supplier could cause severe disruption of supply chain.
- While Ford has too many dealers at this time, it should remain wary of too many closures. In addition, because Ford Credit provides financing for most dealers it must be careful to avoid holding the bag when dealerships close.

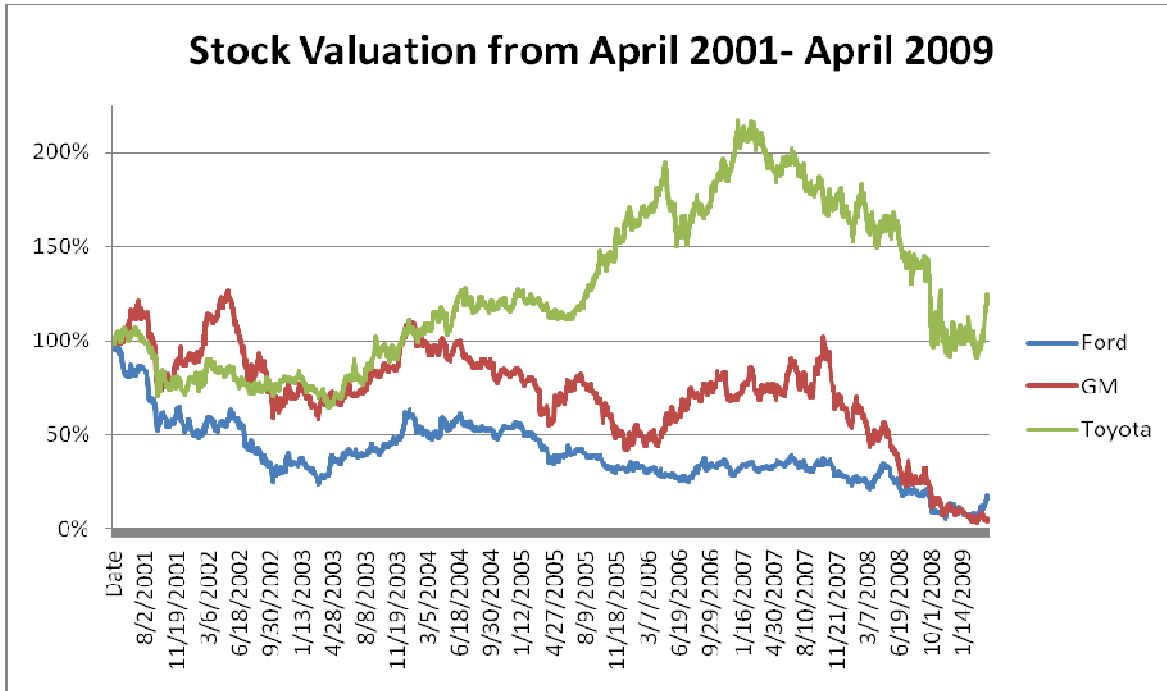
- It is possible that the 'One Ford' strategy could fail. While standardization across regions provides significant cost savings, the success of such a strategy is predicated on consumer tastes remaining consistent enough across geographical region.
- Continued abatement in fuel prices could result in American preferences reverting back to larger vehicles.
- All indications so far are that the new Ford Fiesta will be a success in North America. However, the failure of the Ford Fiesta in the American market would be disastrous for the company. Ford has staked its future on the Fiesta, and while early reviews are positive, North American acceptance is critical.
- Weakness of the supply base: most Ford suppliers rely on contracts with GM and Chrysler. A bankruptcy of one or both could decimate Ford's suppliers.
- Current managed bankruptcy proposals for General Motors could allow GM to emerge from bankruptcy in a significantly advantaged cost position.

## Financial Analysis

### Overview

Ford is one of the largest automobile manufacturers in the world, with a current market cap of approximately \$10.16 billion. The past five years have been particularly unkind to shareholders of American automakers, however, and the equity valuation of both General Motors and Ford Motor has fallen precipitously. Whereas Ford stock traded above \$14.00 per share in February of 2005, it closed at \$4.00 on April 17<sup>th</sup>, 2009. Ford experienced record losses in 2008, burning through cash on hand at an unprecedented rate. Ford will likely post continued losses through the 2009 fiscal year, and even optimistic estimates predict that the company will not return to the black until 2011.

Chart Four

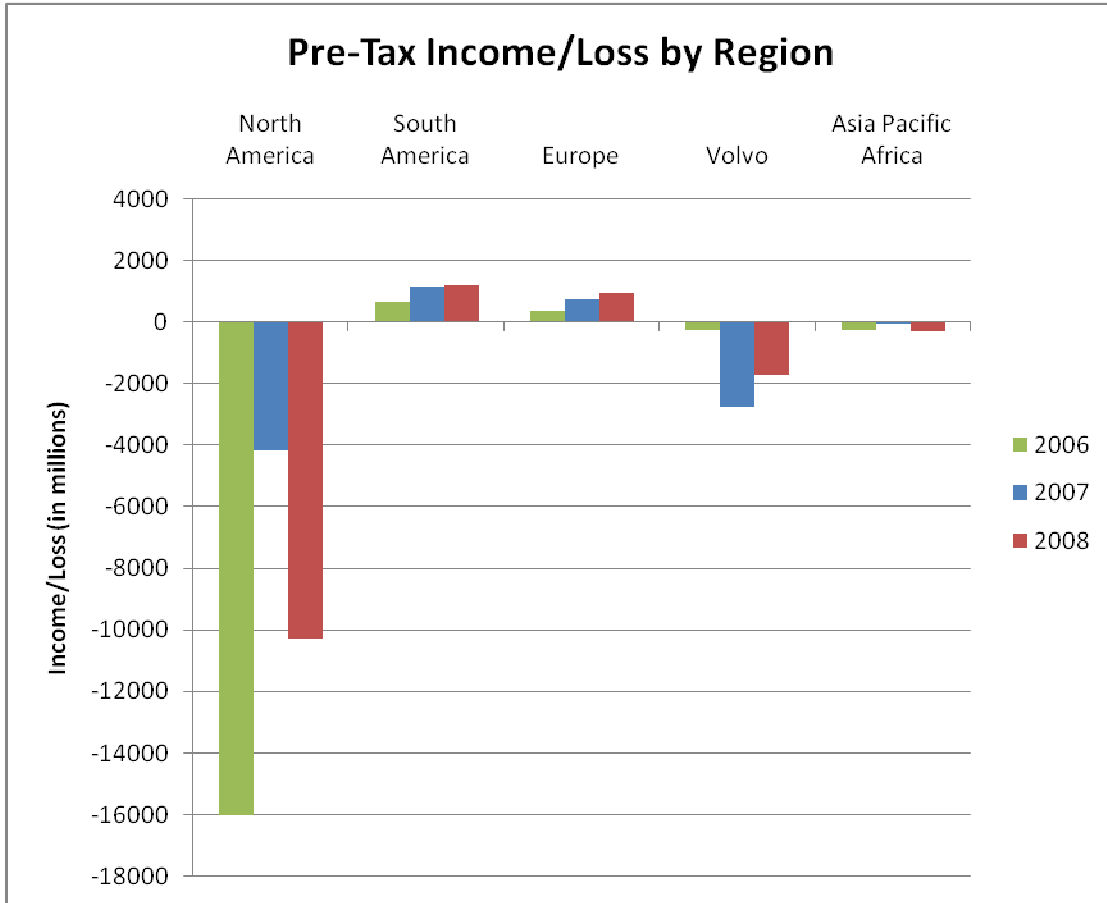


Valuation over time for Ford, GM, and Toyota<sup>10</sup>

### Profitability and Growth

For financial year 2008, Ford reported a net income loss of 14.57 billion dollars (\$6.41 per share). The Volvo brand, which Ford is rumored to be shopping, lost \$736 million in the fourth quarter for a total yearly loss of \$1.5 billion. South America and Europe were two bright spots on the balance sheet, but the fact remains that unless Ford can stop the hemorrhaging in North America it will not survive. The fundamental issue which Ford must address is its inability to manufacture small vehicles in the United States that can be sold for a profit.

Chart Five

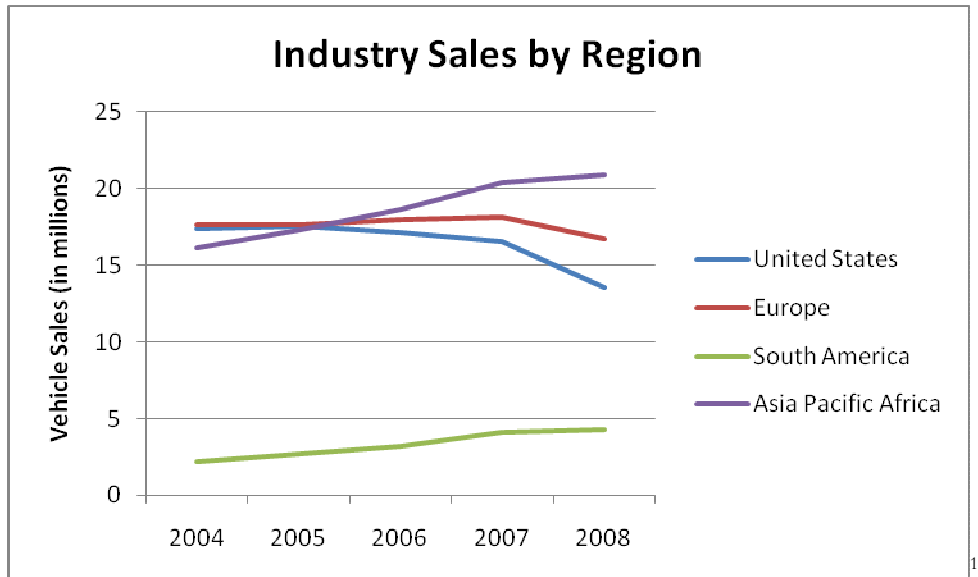


Ford has engaged in a strategic downsizing since 2004 within the United States, ceding market share to rivals GM and Toyota. Ford management recognizes that the company still is not properly aligned with current demand, and has divested from many factories in the past five years. Currently, Ford (under the brands Ford, Lincoln, Mercury, and Volvo) maintains about 15% of the U.S. domestic market share. In 2008, 13.2 million vehicles were sold overall in the United States; estimates for 2009 are far bleaker, with predictions typically ranging from 9 million to 12 million. From January-March 2009, sales were down 38.3% from the same time frame in the previous year.<sup>12</sup>

In 2008, the company sold approximately 5.4 million vehicles through over 13,000 dealerships worldwide. Ford’s market share in Europe is currently 10%, with an estimated 1.67 million sales. Strategically important countries within the region include Turkey and

Russia, where Ford has achieved above average market penetration. Ford market share in Canada and Mexico hovers near 12%, while market penetration in China and India remains extremely low (1.9% and 1.4% respectively, compared to 12% and 10% for General Motors).

Chart Six



Note: Regional divisions above are based on Ford's own classifications.

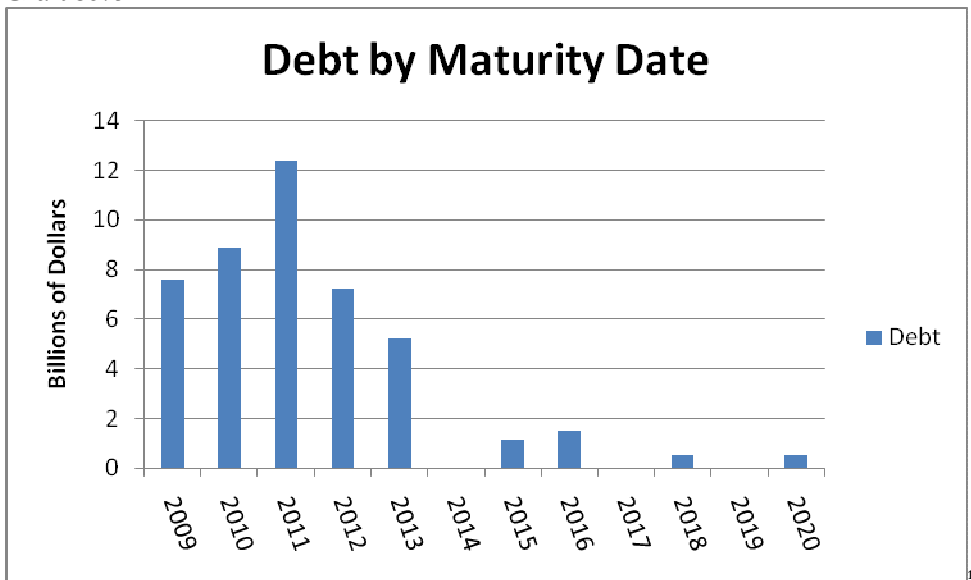
## Liquidity and Solvency

Barring a further deterioration in financial conditions, current estimates predict that Ford will remain solvent through 2009. The company entered 2009 with approximately fifteen billion dollars in cash on hand, and drew an additional ten billion dollars from its revolver in February. Credit Suisse estimates predict Ford will burn through 7 to 8 billion in cash in 2009; unless automobile sales deteriorate further, solvency should not be an issue for Ford in 2009.<sup>14</sup>

In late 2008, GM and Chrysler began negotiations with the government to act as a lender of last resort to prevent the sudden bankruptcy of the two companies. On December 19<sup>th</sup>, 2008, the automotive bailout was approved by President Bush and extended \$17.4 billion worth of loans to the two automakers. Further loans were requested and approved in the

first quarter of 2009, however this money has come with stricter restrictions designed to force the companies to demonstrate “long term viability”. On March 30<sup>th</sup>, GM CEO Rick Wagoner was forced to resign as a stipulation attached to this additional short term financing provided by the U.S. government. Should Ford be forced to seek additional credit in 2009, an occurrence that we consider unlikely, it would likely be able to petition for and receive government loans.

Chart Seven



We believe that Ford’s recent repurchase of debt (announced April 6<sup>th</sup>, 2009) was a very productive step towards ensuring long term financial security. This \$9.9 billion debt reduction was achieved with \$2.4 billion in cash and the issuance of an estimated 468 million shares of common stock. This restructuring at less than half of par significantly improves Ford’s balance sheet, and represents an estimated interest saving of 500 million in 2009 alone.

## Strategic Recommendations

The following strategic recommendations are designed to address short run and long run problems facing the company. We believe that Ford faces three distinct challenges:

- 1) The need to minimize cash burn and bring costs down as quickly as possible in order to stay afloat in this difficult economy. Losses must be brought under control by 3Q 2009 or the company will face extremely difficult choices regarding its future.
- 2) The bailout of General Motors and Chrysler has placed Ford in a strategically difficult position. While Ford is currently in a much better financial position than GM or Chrysler, government funding of these competitors generates significant risk. A highly managed bankruptcy—such as the one being proposed for GM—may lead to a significant GM cost advantage, thereby mitigating all of the progress Ford has made in recent years. In addition, any bankruptcy or liquidation could seriously disrupt Ford's supply chain.
- 3) Ford must execute the 'One Ford' vision and continue to differentiate itself from its competitors even as the economic crisis unfolds. The failure of 'One Ford' or the Ford Fiesta model would be disastrous for the company. In recent years, Ford has redeveloped a coherent corporate strategy. Ford has avoided the need for government funding because of its timely financing and strategic proactiveness. It is critical, however, to continue these positive trends with the end goal being global profitability and recapturing market share. Ford should not lose sight of the bigger picture while attempting to capitalize on GM and Chrysler's current weakness.

What follows is a list of specific steps we believe the company should evaluate. We believe that Ford's singular focus should be to take the necessary steps to allow short term survival while ensuring profitability is reached by 2010-2011. We believe that Ford's management is on the right track, but recent progress is tentative and could easily degenerate given current market and industry conditions.

## Divest Volvo

In order to be truly effective, the Volvo brand should have been more fully incorporated into Ford's organizational structure and strategically differentiated from Ford's other lines. Volvo has an excellent reputation, and targets upper middle class consumers looking for an ultra-safe luxury vehicle at a price point below Mercedes and BMW. Thus, Volvo had the potential to serve within Ford's premium line of vehicles, existing at a price point comparable to Lincoln. As it stands right now, however, Volvo does not fit in to the 'One Ford' strategy being pursued by the company and its losses continue unabated. Given current economic conditions, we believe that the sale of Volvo should be a high priority of Ford. If completed, this sale should bring in at least an additional five billion dollars worth of capital, which could either be kept as cash on hand or be used to buy back debt in a manner similar to the April 2009 restructuring.

In addition to pursuing all available offers, we encourage Ford to specifically target Volvo Group, the Swedish parent company which sold Volvo Cars to Ford in 1999. Volvo Group continues to manufacture trucks, busses, construction equipment, and boats within Sweden. Ford, through the Volvo Cars subsidiary, accounts for 15,000 jobs in Sweden, and in December 2008 the Swedish government issued a \$3.5 billion bailout of Volvo Cars and Saab.<sup>16</sup> Thus, a precedent already exists for government intervention. We believe that Ford should leverage this and pressure the Swedish government to support the repurchase of Volvo Cars by Volvo Group. It is possible that the government would be willing to provide significant support for the deal, especially if the alternative is an extensive downsizing of Volvo Cars. While Volvo Group is not the most likely buyer at this time, it represents the least long term strategic risk to Ford because it poses much less of a threat to Ford's major markets than a sale to a low cost Chinese car manufacturer would.

Volvo's worldwide presence and brand reputation make it an attractive target for a car company seeking entry into the U.S. and the Euro Zone. There are a number of car companies desperate to gain such access, and two commonly rumored buyers of Volvo Cars are Chinese carmakers Geely Automotive and Chery Automotive. We believe that the

market value of these companies—\$435 million and \$3.5 billion respectively—makes such an acquisition unlikely, however. Chang’an Motors—which operates Ford’s Chinese joint venture Chang’an Ford—has also been discussed as a potential buyer. Should any of these firms be able to procure the necessary funds, Ford should not hesitate to execute the sale of Volvo. While the use of Volvo as a beachhead for another low-cost competitor would be unfortunate, the fiduciary benefits in these uncertain economic times are undeniable and outweigh these concerns.

## **Factory and Supply Chain Management**

Ford should continue its aggressive push to close and idle factories, with an emphasis on those factories within the United States and the Euro Zone. In addition to executing these previously announced closures, we strongly believe that Ford must restructure its supply chain more quickly than previously anticipated. Ford currently has approximately 1,600 suppliers, and intends to reduce this number by 750. Current instability within the market, particularly the potential bankruptcy of a competitor, heightens the importance of this reduction and leads us to recommend deeper cuts in the number of suppliers Ford contracts with. Ford must examine all of its suppliers and identify those which are critical to the supply chain. These companies should be prioritized above all others in the distribution of contracts.

Of particular importance is Visteon, with whom Ford conducted approximately four billion dollars worth of business in 2008.<sup>17</sup> Initially vertically integrated within Ford, this subsidiary has faced difficult times since being spun off in 2000. Visteon was nearly forced to declare bankruptcy in 2005, and only avoided Chapter 11 because Ford purchased several non-performing production centers from the company (the so-called ACH plants which Ford has now nearly wound down). A disruption in production at Visteon, or other suppliers, is the greatest short term threat posed at this time. Visteon’s UK subsidiary has already filed for bankruptcy, and the company does not currently have enough cash on hand to last through the year. Visteon has secured waivers from the SEC to continue operations through May 30<sup>th</sup>, but we believe Chapter 11 bankruptcy is imminent after this date unless the government

extends an additional line of credit to parts manufacturers. We at Oasis strongly urge Ford management to make extensive preparations for Visteon's failure. Viable alternative suppliers should be identified in case bankruptcy seriously undermines Visteon's ability to fulfill contractual obligations.

Oasis Consulting is prepared to step in and undergo a complete evaluation of all 1,600 suppliers and present recommendations for specific reallocations of contracts. With access to Ford's proprietary data and through an evaluation of the sources of these companies' contracts, Oasis Consulting can ensure supply chain stability for Ford even in the most dire of circumstances.

### **Prepare for Liquidation of Chrysler and/or Bankruptcy of GM**

Ford should prepare extensive plans for how to deal with bankruptcy of a major competitor. As of this writing, Chrysler has until April 30<sup>th</sup> to reach terms to be purchased by Fiat or the government has stated it will withhold further capital infusions, effectively forcing liquidation. The Fiat deal is predicated on Chrysler's ability to gain major concessions from debt holders and the Union of Auto Workers. As the smallest of the Big Three, the company with the least government investment, and the least flexible debt situation, a liquidation of Chrysler seems likely to us at Oasis Consulting. We believe that the government may view this as the least harmful solution to the long term problems facing American car manufacturers. It would also ratchet up pressure on GM, which employs many more American workers and has much greater government investment at this time.

GM has until June 1<sup>st</sup> to prove financial solvency or it will be forced into bankruptcy proceedings. As with Chrysler, the company must reach agreements with the UAW to cut labor and legacy costs and work with their creditors to restructure long term debt obligations. Of the two, the latter is more difficult. In order to achieve the necessary restructuring, it is estimated that 90% of GM creditors would have to accept debt conversion of approximately ten cents on the dollar, with the balance given in GM stock. Government debt has less priority in bankruptcy proceedings than traditional debt, therefore

it is in the government's interest to avoid bankruptcy proceedings. Because the fate of Chrysler will have such a great impact on the future of General Motors, we do not believe it is appropriate to predict the fate of GM at this juncture.

Regardless of whether GM does file for bankruptcy or not, Ford must ensure that GM is not explicitly or implicitly made into a national champion. Part of Ford's strategy moving forward must be to extensively lobby both Congress and the American people. We believe Ford can demonstrate how providing too favorable conditions to GM will undermine the only healthy American manufacturer—Ford—and cause long term damage to the American auto industry. In the event of a GM bankruptcy, the most likely scenario being suggested is a quick process whereby GM is divided into healthy and unhealthy assets. The "good" GM would then emerge from Chapter 11 while the "bad" GM would be wound down. This plan represents an extraordinary amount of risk for Ford, because it would allow GM to significantly lower its cost structure and undercut Ford in the medium run. If this specific scenario does take place, we believe Ford may be forced to restructure under similar conditions or risk losing market share in the long run.

Until a decision regarding GM's future is reached, Ford should continue extensively marketing its vehicles to exploit the competitive advantage which has been created by GM's dubious future. We specifically recommend taking advantage of the unease among consumers regarding the legitimacy of competitors' warranties. Small increases in U.S. market share have already been seen, and increased market share during this weak economy is a critical step towards lowering average total costs per vehicle.

The bankruptcy or liquidation of either of these competitors would reverberate throughout Ford's supply chain. While we do not doubt that the government will attempt to mitigate the impact of any Big Three failure on the industry suppliers, we fear that the sudden exit of many suppliers is inevitable. The risk of a complete industry failure resulting from such extensive supply line disruption is non-zero, and thus must be treated with the utmost seriousness.

## Product Differentiation

In addition to the short term recommendations highlighted above, Oasis Consulting believes it is critical that Ford continue to prepare and execute longer term growth strategies. Ford's viability hinges on its ability to successfully differentiate itself from its competitors, both through price and quality. We believe that the 'One Ford' vision currently being pursued is a sound and cogent strategy, but it does have its risks. First and foremost, we are concerned that the 'One Ford' strategy may be over-pursued. Regional product differentiation is necessary to ensure that products are sufficiently geared towards disparate global preferences. Secondly, while we recognize management was under significant pressure to affect change, Ford should never again stake so much of its future on one line of vehicles. The Ford Fiesta "World Car" will determine the future of Ford, and while early reactions and sales are positive Ford should create a high end equivalent to the Fiesta to capitalize on similar cost savings measures.

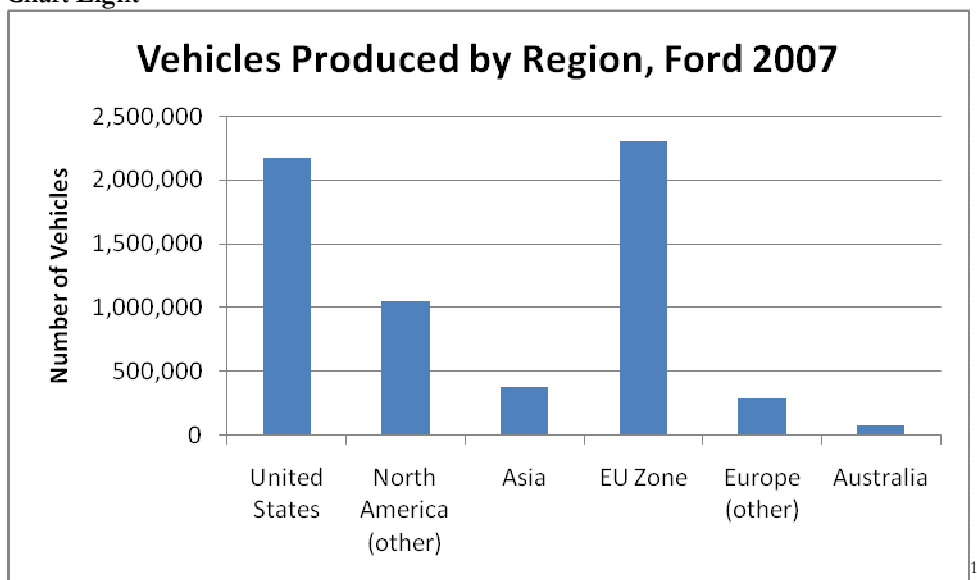
We applaud Ford for its investment in fuel efficient technologies and its recent development of the Ford Fusion hybrid. Although Ford is a late arrival to the growing hybrid market, the company has succeeded in delivering a vehicle which is instantly competitive because of its quality and price. While Ford is still at a disadvantage compared to Toyota in this subsector, it has launched a lineup of vehicles that has a chance to redefine the competitive landscape.

Based on recent reviews, we believe that Ford has significantly improved vehicle design processes and factory quality control. This bodes extremely well for Ford's long term success.

## Shift Production to Mexico and Eastern Europe

We believe there is no reason for Ford to continue producing the majority of its vehicles within two regions with extremely high labor costs: the United States and the Euro Zone. As can be seen in Chart Eight, the United States and the EU Zone account for the overwhelming majority of production. We believe that Ford should attempt in the long run to shift much of this production to Mexico and Eastern Europe, which offer the necessary geographic proximity while having far lower labor and production costs.

Chart Eight



This strategy should take place slowly over several years in order to minimize the negative public relations and branding effects which may result. In particular, Ford must be wary of losing its perception as a thoroughly ‘American’ vehicle. The closure of nonperforming plants within North America from 2006-2008 has set the stage for any future growth to take place in Mexico. In Europe, we believe that this reallocation can occur more quickly and in a much more extensive manner because there is less risk of a consumer backlash. In 2007, Ford invested \$88 million to acquire a car manufacturing plant owned by the Romanian government and has also announced plans to invest some \$3 billion in manufacturing facilities in Mexico. We hope that these are the first steps in a broader shift in production towards lower cost locales.

## Expand Market Share in China and India

The Chinese automobile market has experienced consistent growth in the past ten years, and 2008 industry sales surpassed the United States for the first time with nearly ten million vehicles sold. Ford currently holds agreements with Chang'an Automotive of China; through their joint venture Chang'an Ford the companies manufacture the Ford Focus, Fiesta, and Mondeo lines. In 2008, this joint venture sold approximately 204,000 vehicles. As a result of a recent stimulus package passed by the government, Chinese demand for vehicles is expected to rise by nearly 20% in the year 2009. China is the only major market in which sales growth, let alone growth of this magnitude, is expected. Yet Ford currently holds only a meager two percentage points of market share in China.

The Ford Fiesta is already experiencing strong sales in China, and we believe that this vehicle is the key to enhancing Ford's market share. We at Oasis believe that sales of the sedan and hatchback Fiesta models combined should surpass the 100,000 unit mark and significantly boost Ford's overall 2009 China sales. Given the economic incentives provided by the Chinese government and GMs ongoing difficulties, we believe now is the opportune time for Ford to make a full push to steal market share in China and establish itself as the dominant American brand. While there is inherent risk to this strategy, we believe that a narrow window of opportunity exists for the company to overcome its poor start in the Chinese market.

India is a much smaller market, with industry sales holding steady at two million over the past two years. After twelve years within the Indian market, Ford has little progress to show. Unlike China, Ford would need to make a significant capital investment into the Indian market if it wished to ramp up production. Monthly sales only recently exceeded 2000 units, and Ford only has dealerships in 78 Indian cities. Given the current economic uncertainties, we do not believe that Ford should invest significant capital in the Indian market at this time. Once the global economy has stabilized, however, we believe Ford should revisit this question and seek to expand its operations in India.

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