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Opportunity in Adversity: Building Ashok Leyland 4.0

From time to time in their professional lives, CFOs are instrumental in driving radical internal change, and even business transformation in the organisations they steward. Gopal Mahadevan epitomises that capability. When Mr Mahadevan joined Ashok Leyland in 2013, the industry was in the midst of a crisis and the firm beset by falling sales, shrinking margins, and plummeting share prices. Working closely with the Managing Director and other function heads to effect a turnaround, Mr Mahadevan's focus was solely on profitability and cash flows – a message that had to be instilled across the business. Unviable lines were shut, Management Information Systems revamped, working capital reduced and the company effectively restructured. Consolidation was the new imperative. By his own account, there was no 'rocket science' involved in what had to be done, but it did require solid execution, and strong collaboration – and at the core, clear recognition across the board, of the unviability of status quo. The turnaround that occurred was possibly one of the fastest in Indian corporate history, and Ashok Leyland is today on solid ground, with enhanced market-share and robust profitability. However, like any journey, this one, too, is far from complete, and there are new challenges to overcome in the times ahead. In interactions with *CFO Connect* and with the wider IMA India CFO Forum, Mr Mahadevan shared valuable lessons on what worked and what did not in turning around Ashok Leyland.

FROM SMOOTH SAILING, TO A PERFECT STORM

For much of its 70-year history, Ashok Leyland has stayed ahead of the curve, and in its first 65 years, it was a consistently profit-making company. There was no real competition, with the market split 25:75 between AL and Tata Motors, and the industry was predominantly a seller's market. Profitable from inception and very tech-savvy, AL has led many of the biggest innovations in the Indian Commercial Vehicle industry, from introducing air brakes, double-deckers and power steering, to the latest Exhaust Gas-Recirculation BS IV systems. It believes not only in following best practices, but also defining next practices in CV technology.

The rumblings of disruption began in 2005, with the entry of new players like Mahindra & Mahindra, Eicher, and Bharat Benz, and a surge in industry capacity. Recognising this as a minor blip as the market expanded, AL continued to invest heavily in capacity and in adjacent businesses, including Construction Equipment, and in a few other initiatives. Around 2012, however, the market was hit by a perfect storm – a slowing economy drove industry volumes down 50 per cent from 350,000 to 200,000 units per annum in just two years. Given that industry capacity was far in excess of demand, discounts jumped from Rs 20,000 to Rs 250,000 per vehicle, turning the market into a buyer's market overnight. Weighed down by high overheads and heavy capex, AL's debt swelled alarmingly. Even as AL remained fiscally prudent, its outstanding debt rose from Rs 40 billion to Rs 62 billion in a matter of months. Working capital was at 37 days and the stock price had touched Rs 11, well below the book value. All of a sudden, the company was in survival mode.

ASHOK LEYLAND 3.0: REINVENTION

Plainly, Ashok Leyland would have to restructure and reprioritise – and in 2013, it began doing just that. Its debt was too high and its stock had taken a beating. The team's entire focus shifted to making the business profitable again, to bringing the fabled company back into the black.

Gunning for cost reduction – and selling non-core assets

AL put together a dedicated team of 25-30 of its best employees, handpicked from various departments, for a cost optimisation programme. This team – codenamed 'K-54' – was given the mandate of cutting all costs, including interest, depreciation, and non-cash charges to improve PBT. The target was deliberately set high – exactly double what was absolutely necessary – to create a buffer in case of any misses. The advantage of a dedicated team

To optimise costs, a cross-functional team was set up, but it eventually co-opted the entire organisation into the effort.

was multiplied by co-opting the entire organisation into the effort, leading eventually to a positive shift in culture and outlook. This was enabled by a leadership that set the right tone, communicated regularly and most importantly, was accessible. This culture is now ingrained in the firm and its leadership. Finance as a function played a critical role of not only showing the mirror but also providing the 'binoculars' of opportunity and efficiency. A systematic knowledge-management structure was set up to invite cost-cutting ideas from across the organisation, and to track implementation. Every idea at AL now goes through three stages, and is then validated by the Finance team.

Employee costs were also trimmed, with low-performing employees (about 10 per cent of the total) being given an exit opportunity. Specifically in Finance, the headcount has come down from 287 to 205 in the last four years, even as revenue has doubled to Rs 180 billion.

Following seven months of rigorous effort, the team managed to remove Rs 7.5 billion worth of costs.

Simultaneously, Ashok Leyland went after waste elimination disruptively. There were to be no holy cows: the target was to reduce the BEP by 30 per cent. The Finance office then focused on optimising the firm's operating working capital needs. An automated review process was installed, providing granular information that allowed it to identify any inefficiency in its management of working capital. (This information was shared in advance with business divisions to avoid any surprises during formal reviews.) The rigour of review in understandable and manageable 'bits' -was also crucial to success. In just four months, this helped bring down working capital from Rs 14 billion crores to Rs 2.3 billion in March 2014. In 2016, a new method was introduced to compute moving average working capital – similar to how banks calculate interest on capital used – and this has already generated significant interest-cost savings.

Additionally, by immediately 'turning off the taps' of further bank funding, people quickly came to realise they needed to look internally for cash.

AshoK Leyland simultaneously looked to achieve both cost improvements and aggressive growth. It pruned products that yielded low margins, and at the same time invested regularly to develop a pan-India presence

Aside from reducing operating working capital, Ashok Leyland also sold many non-core assets, which included investments such as real estate. With cash in hand, it was able to reduce its debt-equity ratio. Also, the loan book was restructured to replace short-term loans with long-term ones, thus cutting interest costs and freeing up cash flows.

In recognition of the needed balance between continued investment to grow the business and payback on capex, the Finance office developed a clear capital investment policy: it must earn a minimum IRR of 20 per cent on long-term projects. For short duration projects, the payback period should be less than 1.5 years. With these guidelines in place, the firm has managed to bring down the development time for intermediate and commercial vehicles from three years to nine months.

Enhancing the focus on efficiency and quality

AL has set in place stringent processes to improve its forecasting accuracy on product development, manufacturing, and sales. There was a disruptive focus on enhancement in quality. Finance has been spearheading a process improvement initiative – 'Aspire' – that aims to reengineer processes in HR, Finance, Quality, and Indirect Purchases. The goal is to eliminate redundancies, automate processes, and outsource areas where there is scope for cost saving. This has enabled greater efficiency as well as a stronger focus on the customer.

Revisiting the portfolio and diversifying dependence

A critical element of AL's 'reinvention' was to review the product portfolio, both current and planned. 2013-14 would have truly been an annus horribilis, but it was also the year the company embarked on its turnaround, and one in which it had its maximum number of new launches. The rationale was that, unlike other industries, trucks and buses have a long shelf life, and these products are continually upgraded and refined over time. Further, it continued to invest in developing a truly pan-India presence, moving beyond its traditional, Southern Indian stronghold.

This proved far-sighted, because today, AL is able to service and grow its market mainly thanks to its new products and enhanced network. Concurrently, AL decided to prune anything that yielded either low or no margins. It immediately stopped producing about 15 per cent of its portfolio, or re-priced its offerings even under tough market conditions.

Selecting and tracking key metrics: End-outcome recognition is key

To ensure strong alignment between effort and business need, AL concentrated on three critical metrics: market share, operating working capital and EBITDA margins. All targets, goals, and outcomes were linked to and tracked along these metrics. This represented an equilibrium triangle: any change in one component would impact the other two. MIS systems were revised to include the new metrics along with the profitability numbers. The intention was to make the front-end staff better understand the profitability numbers. Despite initial concerns about information confidentiality, this move to share sensitive information with employees had a dual effect – it created urgency and clarity on goals at the front end, and it generated confidence by displaying categorical trust in employees. With all these efforts, EBITDA moved up from -5 per cent to +6 per cent in just one quarter, i.e. from Q3 FY14 to Q4 FY14.

Restructuring the business

Next, the company was cut into manageable parts. From a single monolith, it was split into six businesses – including Truck, Bus, After Market, Power Solutions, LCV, and Defence. At the P&L level, it was broken down into 30 segments, a number that later grew to 250, and today 450. Every business head, zonal manager and regional manager now has a P&L responsibility. This information however is kept simple at a metric level – market share, EBITDA and operating working capital to make it easily manageable.

Keeping stakeholders informed

Simultaneous to all of this, AL kept stakeholders informed throughout this journey – never promising outcomes, but sharing the measures that were being taken. Throughout this process, the CFO's ability to consistently and transparently communicate both intent and decisions to a wide map of stakeholders was crucial. Investors, bankers and internal management were provided detailed assessments of decisions taken and progress made, including, crucially, errors or disappointments. In the case of internal stakeholders, it was essential to involve them early on to avoid any possible resistance. The key was to share details in the form of storytelling, thus creating both believability and 'connect'. Staying brutally honest, Mr Mahadevan

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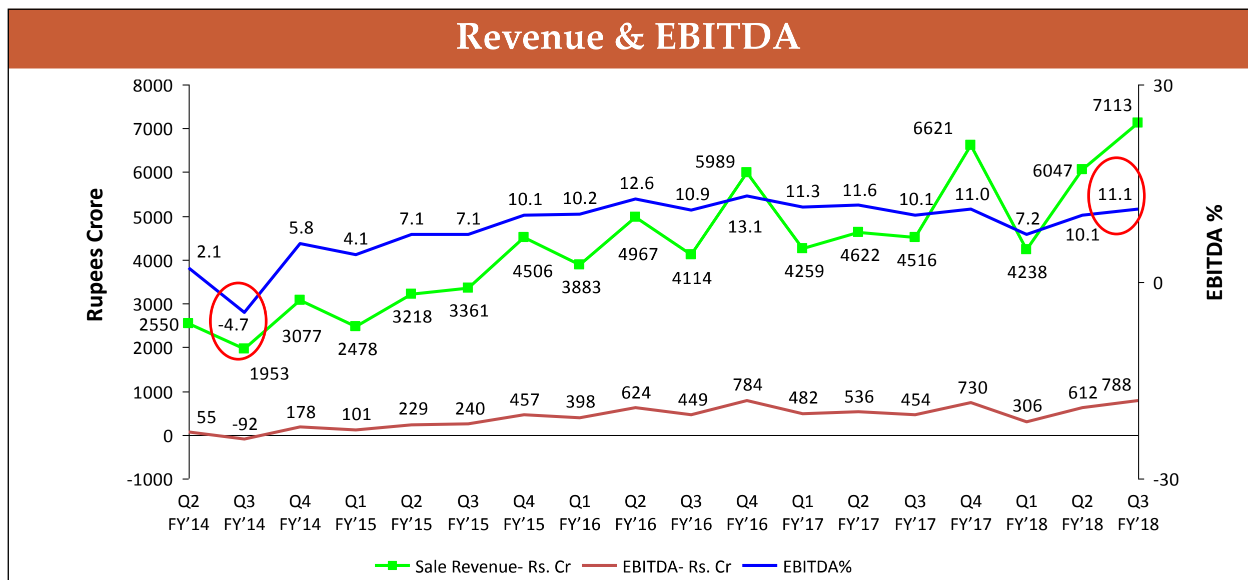

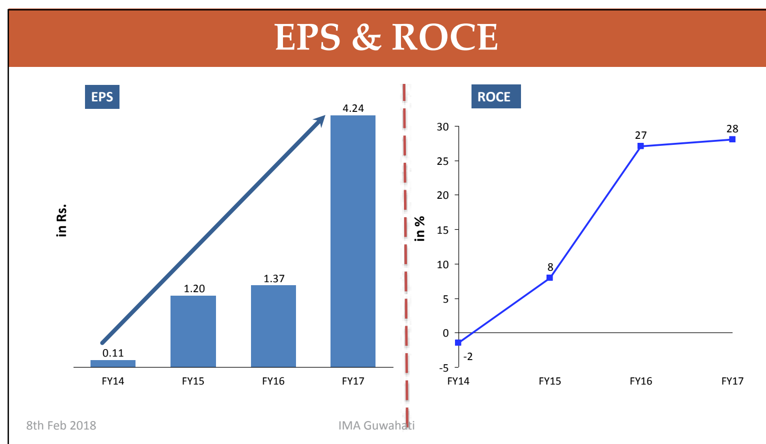

would tell them that Ashok Leyland was a bit overweight, but that it was getting back in shape, and no longer in danger of going into the ICU. Gradually but surely, investor confidence returned.

Raising capital

Combined, these steps brought Ashok Leyland to a point where it could again raise capital. In July 2014, 10 months into the restructuring exercise, it generated Rs 6.7 billion (USD 111 million then) through one of India's fastest QIPs, at Rs 36/share. Although it knew that it would be able to fetch a higher price if it waited a bit longer, it felt like the right time to draw down its debt further, and to infuse new money into the firm. The required equity dilution was minimal, and the issue sailed through in no time.

THE PAYOFF

As AL became more profitable, it regained confidence internally. The network it had invested in – which included spends on dealer and service network, allowing them to get closer and be more responsive to end-customers – boosted its market share, to nearly 34 per cent currently. A restructured balance-sheet today only has upsides, because any investment that lacked cash-generating potential or was non-core was divested, yielding Rs 1.6 billion over 4 years. Unprofitable subsidiaries, such as a construction-equipment offshoot were closed, reducing the company's cash-burn. During FY14, AL rationalised its staff strength by nearly 10 per cent. From a debt-equity ratio of 2.2:1 in August 2013, it was, as of December 2017, debt free, and its working capital has reduced from 44 days to 6 days. Ashok Leyland has now been consistently posting double-digit EBITDA margins for 11 of the last 12 quarters – especially credible because sustaining this performance requires huge effort, and is far from easy. Its EPS and ROCE ratios are both up strongly.

ASHOK LEYLAND 4.0: DEFINING THE INFINITE

In hindsight, fighting the crisis was, in many ways, probably the easier part: the problems were well defined, and the solutions lay predominantly within the company. As AL, with Mr Mahadevan as its CFO, looks ahead, the focus is shifting to reinvention, to deploying new strategies for the journey from very good to great. Simply doing more of the same will not suffice – industry is changing more rapidly than ever before in a digital economy that is about sharing, and about productivity. Even as the risks may be many, the greatest perhaps is not being able to change with time.

A three-pronged strategy...

Going forward, Ashok Leyland has three broad goals on revenue: pursue domestic growth; grow the acyclical businesses; and drive up the share of international revenue. Even during tough years AL did not cut spends that affected its capacity, capability or brand. Its perseverant expansion of network from 350 points of presence seven years ago to nearly 2,800 points today has yielded results. While the domestic truck business remains its bread and butter, it is important to de-risk the organisation by growing other businesses in parallel, and there are programmes in place to methodically achieve this. At the same time, it is moving from being a pure products business to becoming a 'solutions' provider. From building innovative trucks, it is now making them digitally-enabled and intelligent. Further, the company is now looking to capture more of the entire lifecycle revenue of a vehicle and not merely its sale value, which accounts for 10 per cent of the total opportunity. AL is now looking at business models

During a turnaround, it is critical for the CFO to clearly communicate with internal and external stakeholders, continuously receive feedback, and create a virtuous cycle of information flows, ideas and decisions

that can get it into a bigger part of this opportunity.

Finance will need to partner business in driving this – as decisions on capital allocation, revenue streams, investment structure and funding will need to be the back bone for these initiatives. Plainly, Finance is integral to this Blue-Ocean strategy.

Stay relevant, stay ahead

The world of tomorrow will be one of great opportunity, but also of massive disruption driven by regulation and customer preferences. Crucially, pure manufacturing excellence is starting to become a given, not something that commands a premium any longer. Vehicles should not only be efficient, but also intelligent. Manufacturers are expected not just to sell products, but to provide innovative solutions. Business models will change, too, as today's end-customers, in some cases, give way to aggregators. Companies like Ashok Leyland will need to respond appropriately.

Over the next decade, automation will change the nature of work and the functioning of society, thereby impacting both employment prospects and end-demand. Many traditional capabilities – at both the individual and the organisation level – will see disruption on account of AI and automation. New strategies will be needed for businesses to survive and grow – and in some industries, the 'moats' that companies have built around themselves will no longer be sufficient.

For CFOs, all of this will pose critical challenges in terms of decision-making. They will need to move their mind-set from managing risks to riding them. Innovation will be key to staying relevant. And also to staying ahead.

THE WAY FORWARD

In a candid conversation with *CFO Connect*, Mr Mahadevan shared his views on the emergent world of industry - 'Industry 4.0' as it is fashionably called - the challenge and opportunities it offers, and the related disruption of business models.

Technology is causing disruption at multiple levels – in terms of manufacturing excellence using smart technologies at one and product disruption at the other with the rise of electric vehicles. What are the changes that are categorically foreseeable and which you would highlight as the most critical trend?

You need to be prepared not only for disruption but also for the unbelievable velocity of disruption. Preparation is also required for changes that will be driven by unrelated constituents, and also for a value shift from product to customer capability. Historically, the first value creators were manufacturing behemoths, followed by the ones with marketing capabilities, and then by technology leaders. The next phase of value creation will be led by companies that innovate in connecting and retaining customers, and creating needs that did not exist. This will transform the way we live and work.

To what degree is Ashok Leyland, given its already scaled-up manufacturing footprint in India, looking to embrace new technologies, such as robotics, IoT, etc.?

We are very clear that we need to move from products to solutions, and from hardware to digital. AL has one of the most integrated R&D and testing centres in Asia. Our Pantnagar facility is one of the most automated and integrated commercial vehicle (CV) manufacturing facilities in the world. We are possibly the Indian CV manufacturer with the most 'connected' vehicles. The history of India's CV industry is replete with innovations introduced by AL, and we will continue to use that capability to build our strength further. We are looking at transforming our manufacturing capabilities, introducing next-generation products, and connecting with our customers more efficiently. We now use 3D printing to develop our prototypes.

What are the most important challenges you think AL will need to overcome to take advantage of 4.0 and stay ahead of competition?

Industry 4.0 is about smart factories. On top of that, we need to have smart solutions – not just for our customers,

> **Finance needs to shed its traditional role of 'protector of shareholder interest', becoming a 'creator of shareholder value'**

'Finance Time Dollars' should be optimally spent on strategic areas, such as developing robust processes, business partnering, and team- and capability building

but for ourselves – built on the back of Big Data and analytics, which are critical in getting to know your customer better and predicting patterns. There are external drivers, too. Even as we are charting our course from BS-IV to BS-VI emission technologies and making investments for the same, we are also planning our journey from internal combustion to electric vehicles. Industry 4.0 not only means having smart and connected manufacturing, but also building intelligent vehicles that customers need.

What digital initiatives AL is taking to future-proof itself?

Ashok Leyland had formally announced its first set of digital initiatives in August last year:

- 'I-Alert', which gives real-time data on the vehicle performance
- 'E-Diagnostics', which provides diagnostics that reduces vehicle down time disruptively
- 'Service Mandi', a mobile platform that seamlessly connects drivers, mechanics, parts retailers, fleet operators and dealers
- 'Leykart', which provides platform for procuring parts on-line

We are also doing multiple things using Analytics and Deep Learning. We are a very current and 'happening' company that believes in the transformative power of technology

Do you think we have a way to go - say, several years - before most large enterprises can scale to get the real business changes and benefits from digitalisation?

Large organisations will need to adapt quickly, else they will stall. Adaptive planning will replace long-range planning, which can only help identify broad initiatives and strategies that need to be deployed to stay relevant and competitive. The days of Excel spreadsheet-forecasting are gone. Just look at the impact that digital marketing is having in bringing new businesses be it in FMCG, education, payments systems or food.

Any transformation begins with awareness and knowledge amongst employees about the new technologies and operations. What is the effort required in acquiring digital talent, building new competencies, and necessitating seamless skill enhancement? What training interventions are you deploying or planning to deploy to make sure resources are fully geared to face challenges upfront?

Organisations will have to learn to co-create, aside from purely acquiring talent. Digital is not about getting good programmers, but also about identifying opportunities and creating platforms and solutions. A number of start-ups are creating solutions that are disruptive. We will need to co-create with them. Of course, organisations will need to have expertise in steering the digital ship, otherwise we will be all over the place. It is most important for employees to realise the speed of change and the opportunities that will unfold. Change is good; it is no longer 'Business at the speed of thought' but 'Business at the speed of change'.

Going forward, what do you foresee in terms of the changes in the composition of your R&D spends?

More than the quantum, the composition of R&D spends will change. While we will need to build new vehicles and capabilities, we will see investments in new areas, such as connected vehicles, AI and solutions.

In a world where the nature of value has changed from asset- to knowledge-based, what is the Finance function's

Share Price

greatest value to its stakeholders, and how is that value best communicated? How do you see the CFO's role evolving?

The Finance function will have to unlearn itself – like all other functions. A lot of what we have been doing does not create value for the customer. The challenge is that compliance and governance are becoming ever so important, and rightly so. The only way to solve this is to create high-speed channels for transaction enablement with clear walls to make transactions processing so predictable that you do not invest time in reviewing them. Instead, the time should be spent in developing the rules. The entire organisation should be looking outwards and spending minimum time looking backward for non-strategic issues. Therefore, focus the 'Finance Time Dollar' (FTD) in developing robust processes and automating them; re-deploying the FTD to partner businesses, and providing innovative and proactive solutions; and spending the rest of the FTD on team and capability building.

What do you look for in your team beyond skill sets? How do you develop future leaders in Finance?

I strongly believe in enablement. So, I will push my guys into the deep-end of the pool whilst keeping an eye on them. The greatest satisfaction is when you see the next generation of leaders swimming back to the edge. The best way to build future leaders is to expose young talent to what the senior leadership is thinking, and allow the team to come up with solutions. As a leader, you need to learn to choose the options that the teams come up with. It is not easy to let go, but that is the best way.

How do you future-proof the firm against ongoing volatility? What is the role that Finance must play in this?

Finance needs to shed its traditional role as merely a protector of shareholder interest, to becoming a creator of shareholder value. This requires Finance to differentiate itself. Finance is best placed to aid the transformation – with access to information, the ability to spot opportunities and deviations, and to garner resources for funding future growth. We need to move from 'containing risks' to 'riding risks', and becoming a good and equal partner to the business.

The next journey on the profitability curve: how do you ensure that things don't lapse back? And how do you get beyond the operational management personally to ensure a focus on strategy in a business as vast and fast moving as AL's?

The best way is to unlearn and not allow hubris to set in. Enhanced profitability will come from growing the top-line while keeping the middle line on an incremental growth mode. For growth in the top-line, I believe that judicious capital allocation, as well as understanding of business, will be necessary to partner business in its decision-making. For keeping the middle line optimal, understanding and driving of resource productivity are going to be key – be it money, men or material.

AL has started including strategic issues as part of people's KRA and linking them to ratings. Could you share some of yours?

Some of my KRAs include providing customer related solutions, working with product development to enhance the product development process, improving productivity in certain functions, and removing unnecessary processes that do not enhance governance or competitiveness, capital allocation, being in boards of group companies and enhancing investor relations. ■

ON A LIGHTER NOTE

- **Being a CFO to you means:** Customer First Officer!
- **Three important learnings as you look back upon your career?**
  - o Impress on your colleagues that you are not Mr Bean Counter
  - o Make yourself a likeable fellow, but be heard
  - o Learn to dream with your feet on the ground
- **What is the first thing that comes to your mind when you hear the following:**
  - o Communication and the CFOs: Smile – life is not too serious
  - o CFO & Strategy: Joined at the hip!
  - o CFO & Risk Management: Like salt – not too much and not too little!
- **Top three things still pending on your bucket list:**
  - o Becoming a good swimmer
  - o Learning to make an app
  - o Completing the full collection of The Police & Sting!
- **Favourite book/movie:** Jonathan Livingstone Seagull
- **Comfort food:** Bhelpuri
- **What do you do to keep yourself operating at optimum level?**
  - o Eat, Pray and Love your family
- **What does the horizon hold for you in the future – where do you want to go?**
  - o Time will tell. Let me live for the moment.