

***“Over the Rainbow:
Painting a Dream in the Eye of the Storm”***

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J.T. Battenberg III
Chairman, CEO and President
Delphi Corporation

Thank you, Dave [Cole] ... and, good morning, everyone.

I'm honored to once again be part of this wonderful tradition and exceptional forum for discussing our industry's most critical issues. Thank you, Dave, for this opportunity.

I certainly welcome sharing my thoughts – my hopes, my dreams and, yes, my fears – about “The Perfect Storm” that is facing the automotive world.

Since I agreed to share my thoughts today, I have been asked repeatedly: “The perfect storm? ... Haven't we already seen and weathered the worst?” As I have responded many times over, both privately and publicly, and as the topic of this panel points out: “Not yet, we haven't.”

Hyper-competition ... deflationary OEM pricing to the consumer ... break-neck globalization ... tough environmental and efficiency mandates ... stifling regulations ... exploding peripheral costs ... imploding profitability ... massive overcapacity ... rising pension costs ... rising health care costs and runaway commodity price increases – particularly steel and resins ... all are critical issues that continue to shake our foundation. This business is not for the faint of heart.

A few examples ... steel prices have risen somewhere between 30 and 60 percent thus far, this year, alone. Over the past several years, the U.S. has seen a double-digit inflation rate in health care. When added together, corporate tax rates, employee benefits, tort litigation, regulatory compliance and energy costs add more than 22 percent to the cost of doing business in the United States when compared to

our largest trading partners. These are just examples, but suffice it to say that these are tough challenges and I don't see any way to simply ride out this particular storm with the mindset of business as usual. To survive, we all need to rethink our business model – OEMs, suppliers, the government, unions, health care providers ... all of us.

Speaking of “The Perfect Storm,” my hometown is Kansas City, Missouri. This is in the heart of America, smack-dab in the middle of “Tornado Alley” ... next to Kansas, the setting for America's greatest fairy tale: The Wizard of Oz.

This classic story has captured the imagination of children around the world for decades. You remember it: Dorothy, an orphaned young girl, unhappy with her drab, black-and-white existence on a dusty Kansas farm, yearns to travel “Over the Rainbow” to a different world. She gets her wish, dreaming of a tornado that whisks her and her little dog, Toto, off to the Technicolor Land of Oz.

I think this story may apply to those of us working our way through the “Perfect Storm” in the auto industry. Perhaps, we too, can paint a dream. We can develop the right strategies for leading our organizations – and our industry – to safety, security and prosperity in the years ahead. For ours is truly a growth industry. To put it in perspective, let's remember that more than 70 percent of the world's population has never even been in an automobile yet. We are truly in the early innings of this game.

As the song says, “somewhere over the rainbow, skies are blue ... and the dreams that you dare to dream, really do come true.”

Today, we have a real opportunity to “paint a dream in the eye of the storm” ... one that can carry us “over the rainbow” ... and help us to shape our industry’s future, controlling our destiny rather than leaving our fate to chance.

To do this, business leaders in the automotive industry must seek a common mindset to solve our common problems, or run the risk of a similar fate to that of once great industries – railroads, steel, textiles and airlines. In these now-suffering industries, the early leaders who could have made a difference tended to ignore competition, government regulations, market trends, quality, innovation, labor issues, and collaboration with others for their mutual good.

Just as the colors in a rainbow are nearly unlimited, so too, are the visions and strategies needed for weathering “The Perfect Storm.” Let me share my dream. I’m tempted to look to the past or relate how a laser focus on excellence – and a rich portfolio of game-changing technologies – might serve as the winning strategy, but this is an exacting climate in which no single “silver-bullet” solution exists.

Temptations aside, I’m committed to help spawn the answers we need. And, toward that end, “painting a dream in the eye of the storm” may revolve around what I call the five Ps: “Product ... Process ... People ... Place ... and Public Policy.”

Let’s begin with Product ... a cornerstone without which we simply will not survive. To be world-class, all of us must deliver value – OEMs and suppliers alike. And, our customers – vehicle buyers or vehicle makers – want some “wow.”

A basic precept regarding product has always been: “Listen to your customers, or risk losing them.” Yet, the rules here have changed dramatically. We must spur innovation at every level of our industry’s supply chain. And, the penalty for failing is severe.

It’s no mystery why buyers will pay full price and wait months for delivery of certain vehicle models, while other models – even with deep discounts and other incentives – may pile up as inventory. And, it’s no mystery why some inventions from suppliers are in great demand from the OEMs.

I recently read a story in *Business Week* titled, “When Flawless Isn’t Enough.” The author noted that most of the world’s auto brands were steadily improving quality. But, some with the highest reliability rankings were considered nothing special because they lacked what was called the “wow factor.” Our customers by and large understand this – and, as a result, their appetite for innovation appears insatiable.

And, today’s cars and trucks are certainly feeding this need. We’re seeing more and more of the “wow” factor in everything from vehicle entertainment systems to safety systems. For example, the \$1.5 billion-a-year tuner car industry is part of today’s youth culture. It’s really hot ... they’re pushing innovation and consumer electronic demands. Of course, there’s another generation that defines cool technology a little differently – whether it’s a passive occupant detection system that knows when and if to deploy an airbag, or a radar sensing back-up aid that helps detect pets, children, vehicles and other objects when backing up.

The world’s auto industry has its innovation engines running on all cylinders to be sure. In fact, according to the National Science Foundation, the U.S. auto industry spends more on research and development than any other industry group in the nation! Our industry spends more than \$5 billion a year more than the health care industry, and more than \$5 billion a year beyond what software developers invest. This is the seed corn for our future. Our focus on new patents, on R&D, on growth must prevail – cost cutting will only get us so far. The leaders in this great industry must continue to invest to grow ... always understanding what the customer really wants and what they will actually buy.

Great Product – innovations that anticipate customer needs and also deliver some “wow” – is the first unquestioned essential for safely navigating the storm. My hopes for a secure future are centered on this industry’s proven ability to innovate. Yet, my fear is that – as an industry – we may not consistently deploy the collaborative design processes needed for meeting our end customers’ ever-higher expectations of innovation and value. Therefore, we must commit to a higher standard – to working across supplier and OEM boundaries to develop the products that will top both the quality and innovation charts. To do so, we must keep our R&D budgets strong.

Now, let’s turn our attention to Process ... while our markets demand great products with some built-in “wow,” they also demand perfect – and I mean perfect – quality, fast delivery, and reasonable prices. They require “getting lean,” as we say within the industry. So let’s talk process.

Lean process strategies have been around since the time of Henry Ford. Yet, few have embraced the principles as expertly as Toyota ... and, we’ve all been chasing their levels of excellence for some 20 years now.

In fact, I just returned from eight days in Asia/Pacific. In one of my many meetings with Toyota, Watanabe-san, Toyota’s executive vice president of purchasing and member of Toyota’s board, reminded me of the importance of going to the “genba”– or where the work is done. He emphasized to me that this means not just the manufacturing plants but also the engineering process facilities. I believe that enlightened management understands this key point. Process improvement is a team sport and great companies understand that.

Another aspect of process we must tackle is getting capacity right. An interesting sidebar to the automotive overcapacity issue is that some of it is driven by our own cost-cutting and lean efforts, particularly as we become more effective. Those of us who have been advocates of the methodologies of “lean thinking” face unique issues as we “lean out” our plants to become more cost effective and efficient – and make no mistake ... that is

absolutely the right thing to do. But we do not always have the added benefit of immediate new business coming into that “leaned-out” operation to fill up the floor space.

According to *Automotive News*, in 2003, North American OEMs had 2.5 million units of excess capacity. Asia/Pacific added 3.5 million units, and Western Europe had another 1.7 million excess units. That’s nearly 8 million units worldwide. That’s a lot of cars and trucks needed to fill up plants.

We know we have too much capacity. And, as a result, we’re adding cost – all the way down the value chain. New vehicle plants drive new localized supplier operations – some of them dictated by either local government or OEM requirements – and nearly always at an increased cost burden borne partially by the supply community. More infrastructure equals more costs.

I think in any discussion about “process,” we can’t neglect the outcome – higher productivity and better quality. Yet, this does not excuse leaders in our industry from looking at the bigger picture and how our processes drive change that affect our global operations. We definitely need to “lean out” our operations – but we can’t do so in a vacuum. We must collaborate across the industry on ways to work together, not only on the day-to-day supply chain issues, but also on issues with further reach, like plant capacity.

Nearly 20 years ago, the GM-Toyota joint venture at NUMMI was a dramatic idea. The idea was to share production capacity – and it worked. Inside the supply community, several of us have shared facilities here in the United States and even more overseas – and that formula works. Earlier this year, GM and Ford announced they would invest more than \$500 million to jointly design and produce a six-speed automatic transmission in three factories. Delphi has also been very successful in establishing joint ventures in key product areas in strategic locations around the world to share capacity ... we currently have more than 40. I would submit, we need more of those kinds of solutions instead of adding more capacity.

So, adaptive process – an enterprise-wide attention to achieving first-time quality, fast-to-

market delivery and acceptable price – is another key to weathering “The Perfect Storm.” My hope for a secure future rests with our industry’s incredible collaboration on state-of-the-art manufacturing systems, continuous improvement and lean principles. My fear centers on whether we will be able to collaborate to solve our common problems and overcapacity issues. We need more collaboration to turn our process challenges – constrained capital, limited resources, R&D costs and excess capacity – into win-win opportunities for companies willing to partner. That’s the kind of innovation Delphi seeks with other supplier companies – and we need more of it across the industry.

In any dream colored with product “wow” and process “lean,” we need outstanding People – the third P – for shaping the game-changing technologies and for building in value while taking out waste. Exceptional talent differentiates success from mediocrity. Sumus quod sumus ... We are who we are.

So, having the right people – an abundance of creative talent – is another critical cornerstone for smooth sailing into the future. Yet, as one might guess in the face of our industry’s shifting market dynamics, we all will be constantly challenged to achieve the right balance of resources across borders and within diverse cultures. We are faced with continual, increasing needs for more talent in our mature markets, as well as in our explosively growing emerging markets.

Finding this talent in our established markets will be quite a challenge. Demographics will not be our friend in the next 10 years. The U.S. Bureau of Labor Statistics projects a shortage of more than 10 million skilled workers in America by the decade’s end – that’s just six short years away – and, there are not enough in the X or Y generations to replace the rapidly retiring Baby Boomers, those born from 1946 to 1964. So there will be a huge decline in available workers who are 30 to 50 years old – those with the highest knowledge base and productivity. And, the younger “Millenials” are just entering high school and college.

Here in the States, we have a significant gap to manage between the graying of America – and the concurrent talent drain from the

workforce – and the limited new talent that will be available in the near future. Simply stated, the new talent pool, even when they get here, won’t be large enough to fill the workforce need. We will be facing – as never before – a shortage of skilled workers, engineers, IT professionals and college grads ... training and retaining our best and brightest people will be a major challenge AND IT WILL BE UPON US QUICKLY. And, since these young people will be in such short supply, we must figure out how to attract them and retain them in our industry while they get fabulous offers to join other exciting industries.

Faced with this situation, we have some factors working in our favor. The world is a vast resource and ours has become one of the world’s most-rewarding industries in which to work. Our pool of available talent gets much deeper, if we think globally. China’s Ministry of Education reported 700,000 engineering and technology graduates last year, while India’s national association of software and service companies reported another 300,000 in that country. That’s a million new engineers and scientists in those two countries alone. Remember, the U.S. graduates only 62,000 engineers each year.

With our industry outfitted with highly lean production environments and focused on high-tech applications of electronics and software, we are an attractive workplace, but we must market and sell ourselves in a world where shortages make us compete that much harder for the best talent. That is a cultural change for many of us.

So, add great People – rich in both talent and cultural diversity – to the dream we’re painting. But, it’s going to take great leadership on our part to attract, nurture and retain such talent in the years ahead. My hopes are pinned on adding excellence from a variety of cultures and performance from a smaller up-and-coming workforce. My fears question if we can move quickly enough to attract, educate and retain this next generation of talent.

Now, let’s focus on the fourth P, Place. As realtors like to say, location is everything! This is a major factor as one paints our dream, but it

cannot stand alone. Without innovative, top-quality products ... cutting-edge lean processes ... and talented and dedicated people, we can only hope to click our heels three times to whisk us off to some safe haven. Yet, as we all know, "safe havens" simply no longer exist ... not even in the far corners of the world.

To succeed today, most companies must be committed to globalization as a key to survival, growth and prosperity. And, while the world stage offers an incredible wealth of opportunity, the strength of that commitment can simply be stated as: Competing in today's world markets means understanding and pursuing the Best Total Cost – not just the lowest wages.

Granted, some companies choose to pursue a global footprint based on chasing low-labor cost. We read about it everyday. Certainly, the math is compelling. We're all familiar with the higher cost of labor in the United States versus lower cost regions, like China. So, why don't we all just pull up stakes and move? Because total cost and quality must both be considered – like capacity, we must look at the broader picture, and arbitrarily running to low-wage countries is not the answer.

We must maximize the advantages of sourcing in a given region, while minimizing the potential impact of currency fluctuations, difficult logistics, or less-than-adequate infrastructure.

Much has been written in the U.S. about the impact of globalization on our manufacturing workforce. Yet, while evidence is still in the making, global sourcing will end up creating millions of new jobs and strengthen our national economies. According to McKinsey & Company, for every dollar that the U.S. spends on sourcing overseas, we recover \$1.13 in such benefits as cost savings, new revenues, repatriated earnings and redeployed labor. And, considering that hundreds of millions will be gaining middle-class status in both China and India and pulling for U.S. goods, our worldwide trade and wealth will dramatically soar as we globalize.

In part, successfully managing this global integration simply calls for doing what's worked before. The extension of worldwide manufacturing systems – "cut-and-paste" common processes on a global basis, technologies, and mindsets – all geared to lean operations and steered with local expertise, I believe, is part of the answer.

We're taking our Place on a bigger stage ... and, we've reached our "tipping point" in the dream of becoming true global enterprises. My hope is that we can profitably partner, capturing the tremendous opportunities for growth and never repeating our mistakes of the past. My fear is that we may fail to lessen restrictive policies and regulations affecting our sourcing choices, or pass legislation that inhibits free trade and open markets, or increases taxation on U.S. companies, or increases the burden of health care and pensions on U.S. companies.

We just can't let that happen, which leads me to the fifth "P," Public Policy. By this, I mean taking an active interest in current and pending legislation, and our regulatory environment. As chairman of the Business Roundtable's Fiscal Policy Task Force and in my role at Delphi, I spend a great deal of time researching and evaluating how public and fiscal policy impacts our economy, our industry, and our individual businesses.

I believe that business leaders must be vocal and take a leading role in supporting and ensuring growth in the U.S. – specifically encouraging investment and innovation, growing foreign economies, expanding free trade, and improving education and training of our workforce. While I could have spent my entire time here on these four issues alone – let me spend just a few moments to get at a couple of key points.

The U.S. economy is finally showing signs of sustained growth. Job growth is rising – nearly 1.3 million new jobs have been created so far this year. Mortgage rates remain low at six percent; interest rates remain near historic lows; and, inflation is a mere 1.8 percent – quite a difference from the six percent we experienced in the '90s. The University of Michigan Index of Consumer Confidence rose to 96.7 in July, its highest since January, and up from 95.6 in June. However, we must not become complacent. Now is the time to focus on addressing the budget deficit, which impacts us all.

The Office of Management and Budget recently updated its 2004 budget deficit projections, showing a decrease in the deficit of \$76 billion, thereby yielding an estimated budget deficit of 3.8 percent of GDP. Although not optimal, this is not extraordinary by historical standards. Congressional Budget Office projections show that the budget deficit can be brought down to 1.6 percent of GDP over the next 10 years, even with the full extension of the 2001 and 2003 tax cuts that would otherwise expire at the end of the decade. Economic conditions now permit us to pursue a course of maximizing growth while significantly reducing the deficit.

This is why we must continue to pursue policies that will foster growth – like liberalizing trade, reforming our litigation system, making the tax cuts permanent and lowering tax rates – while we work to decrease the deficit. Staying on the path of lower deficits over the next 10 years will require great discipline in controlling federal spending. At the same time, we must avoid risking economic growth by enacting ill-advised business tax increases.

We must also address long-term issues, such as sensible Social Security and Medicare reform, so that we can truly get on the path to sound fiscal policies into the future. In addition, Delphi strongly supported the legislation that recently was passed to provide a temporary two-year replacement for the 30-year treasury bond rate for calculating pension plan liabilities. This represents a good first step toward a long-term, comprehensive solution. Now, we need to continue legislative efforts to find a permanent formula for calculating the amounts companies must pay into their pension funds.

The main point is that in order to foster growth and investment and innovation in the United States, we need to work with our elected officials in Washington and our state capitals not only to increase funding for research and development, but also to attack the burdensome cost structure of doing business in this country. For example, I applaud Governor Granholm's initiative to reform Michigan's Business Tax, which really impacts those of us doing business in this state. And, Congressman Knollenberg asks manufacturers what they need to improve the business climate, and then he goes to work getting the needed public policy changes. There are many examples like this that come to mind. We need more federal and state tax policies that encourage investment and innovation.

We all must take an active role in Public Policy ... we are truly the guardians of our economic futures. My hope is that we can put political rhetoric aside to do what is best for American companies and, by extension, their workers. My fear is that business leaders will take a quiet back seat, never realizing how we can collectively change the course we're on. Through active engagement, we can be heard, and we can make a difference.

So, can I look into my crystal ball and forecast where "Product ... Process ... People ... Place ... and Public Policy" in this dream might lead? No, not really.

Even if we focus on knowing our customers better ... even if we anticipate needs and relentlessly deliver world-beating technologies ... even if we perfect processes for maximum value and lowest cost ... even if we arm ourselves with the best available talent ... and, even if we all commit to promoting the right "Public Policy" to help keep us competitive ... there's no way of knowing what dangers lie over the horizon. That's what demands our dedication and perseverance to making our dreams come true.

This is a serious and substantial test of our industry's leadership. I do not plan to fail in this critical mission. In the Chinese science of strategy, "bing-fa," Sun Tzu says to think about challenges in a new way ... not as fighting others, but as advancing our position to make success inevitable. In The Art of War, written some 2,400 years ago, he said: "Opportunities will multiply ... and we must seize them."

The Perfect Storm presents multiple opportunities to all of us – and, we must seize them. We need "champions" to lead the way ... we need to look ahead and not behind ... and, we need to work together as partners, collaborators and innovators with a synchronized strategy to succeed. Most of all, we need to awaken to the fierce urgency of now!

Thomas Alva Edison, possibly America's most prominent inventor, once said: "The best way to predict the future ... is to create it!"

I believe collectively we can create and paint the dream in the eye of this storm. We can define the key strategies needed to carry us over the rainbow and beyond. It is up to us to create our future and live our dreams.

It's a turbulent time, but an exciting one. I'm pleased to have been able to share my thoughts with you this morning.

Thank you very much.