

Remarks for Larry Jutte
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We are invited to participate in a number of forums that focus on purchasing issues. And we come to these meetings with the same spirit that we bring to our relationships with suppliers. We are here to share what we know ... and listen and learn from the knowledge base and experiences of others.

As an industry ... and as individual companies ... we face many challenges. But let me begin by suggesting that we keep these challenges in perspective. Viewed historically, even with a slight dip in overall industry sales, we are still in an era of record high auto sales. Sales have never been this high, for this long. Certainly, Honda has enjoyed record sales for seven consecutive years.

Having said that, I want to emphasize that Honda has always prepared as if there is a “perfect storm” brewing out there. That means focusing on the customer ... and always remaining lean ... always flexible ... and always a little conservative in terms of the risks we choose to take. We won’t change this approach.

But that doesn’t mean we will stand still. In just over one month, Honda of America Manufacturing will mark the 25th anniversary of the first Honda product to roll off one of our assembly lines in Ohio. And we are planning a nice celebration. But from a business standpoint ... rather than look back ... we are focusing on the next 25 years. Today, I want to explain how we plan to advance by creating new value for the customer. And based on some of the lessons we have learned over the years, I want to offer some views on what suppliers and OEMs should be looking to achieve to maintain strong relationships.

I don’t use the word – relationship – lightly. I think it precisely defines what is required to have a mutually satisfying and successful experience. Whether you are talking about two people or two companies, entering into a relationship is one of the biggest decisions you can make. You must take time to get to know one another and make sure you share the same values. It requires open and honest communication. And it can’t be one-sided ... there must be real commitment from both sides. Well ... I’m not Dr. Phil ... but I hope you get the point.

Honda’s 25 years of manufacturing leadership in North America now includes 12 plants. But, in 1979 ... we didn’t have much in the way of existing relationships with domestic suppliers. Starting production from scratch in America also meant beginning our domestic parts sourcing efforts from virtually nothing.

I say nothing ... and that is true with respect to parts and materials. But we did begin with something more important in my view. We started with a very clear and strong corporate philosophy. A set of principles of what matters to Honda ... principles that guided the process of establishing production operations here ... and that represent the values we bring to every supplier relationship we enter.

This begins with a focus on the customer. The genesis of Honda's 25th anniversary was our belief in "building products close to the customer." But the operative word is not "building" – rather, it is "customer." Everyone talks about the customer. But our basic belief at Honda is that we cannot be satisfied until our customer is satisfied through the life of their experience with our product.

When it comes to how we operate as a company – at the core is something we call "Respect for the individual." Working together in an environment where challenging issues must be resolved every day requires open and honest communication. Respect for the individual is what makes this possible. It is the foundation for teamwork at Honda.

We also believe in the importance of going "to the spot" ... this means getting out of the office ... and going to the assembly line or a supplier's facility to determine the root cause of a problem, before coming up with a solution. No matter what your title, knowledge at the spot is what empowers you to make a decision.

Another important value of Honda is that we are never satisfied with the way things are ... we always challenge ourselves to create new value for the customer. The decision to build products in America is a good example of this "challenging spirit." New challenges that focus and motivate everyone in the company – help Honda create new things for the customer.

Look ... I don't want to preach. But my point in reviewing these elements of Honda's corporate culture is to emphasize that if you are going to have a relationship with someone, you must understand the values that guide their business. And you should understand your own values. Then, consider where matches exist with your partner ... or where gaps exist that need attention.

This is exactly how Honda approached the startup of local manufacturing 25 years ago. We began by trying to identify suppliers in North America that matched our core values. In the early '80s, we were a newcomer ... with new ideas ... facing a very mature automotive supply base. Some thought Honda's value system was more than challenging ... they thought it was unreasonable. There is no question that we were demanding about quality, cost and delivery ... and we wanted to know a heckuva lot more about a supplier's business than most other auto companies at that time.

In our view, we weren't just buying parts. We wanted collaborative relationships ... with a sharing of responsibilities ... and transparency in terms of exchanging information. From the beginning, we have been insistent about our basic objectives of Q-C-D – or quality, cost and on-time delivery. Over the past two decades, this has evolved to include requirements that suppliers play an even more important role in developing parts through early involvement -- and that they effectively manage every aspect of their business.

But we have a clear vision that guides our purchasing efforts ... to develop and manage a competitive and stable supply base for Honda's manufacturing facilities throughout North America. In the early '80s, after starting up in Ohio, our production volume was low ... and our main focus was on finding suppliers that could make the same parts that were being sourced in Japan ... primarily raw materials and larger parts that were more expensive and challenging to ship.

As local auto production accelerated, we were primarily focused on two models ... Accord and Civic. Full model changes for these two models provided new suppliers with opportunities ... and also new challenges. But when suppliers experienced difficulty in meeting our standards, we didn't end our relationship with them. We wanted to help them succeed ... and to see that our relationship succeeds. So, Honda experts went to suppliers for weeks at a time – to help find weaknesses and improve their production characteristics.

Today, our associates still support suppliers. But, now they are looking at company characteristics, in addition to production characteristics ... assessing weaknesses that might be reflected in a supplier's performance ... and supporting countermeasure activities. Few suppliers will let you do this if they think you are just coming in to beat them up over price or quality. But sharing insights so that both Honda and the supplier benefit – builds trust ... respect ... and a spirit of cooperation for the future.

Perhaps the most profound impact on the scope of our local parts sourcing activities, however, has been the growth of Honda's local R&D activities in America. In fact, today, a large part of our North American Purchasing operation is physically located in the same building as Honda R&D Americas Ohio Center – which reflects both the close, collaborative relationship we have with our R&D operations and the importance of suppliers to our product development efforts.

New model development in Ohio began to have an impact in the early '90s with derivative models like the Accord Wagon and Civic Coupe ... and shifted into high gear with the development of exclusive models like the Acura MDX and TL and Honda Pilot and Element. This has meant an increased requirement for extensive qualification and development of suppliers for all processes and components. This includes a growing number of strategic alliances with suppliers on new technology.

Now, we have entered an era of increased autonomy in North American Purchasing. We have established a base of suppliers that compete for Honda business largely against each other – rather than with suppliers in Japan. Certainly, with global models like Civic – which is produced in more than a dozen nations – we place a higher priority on global sourcing. But for models developed in North America – including the upcoming Honda SUT – we look primarily to our suppliers in North America to compete for that business.

Last year, Honda purchased approximately \$13 billion in parts and materials from more than 600 suppliers in North America. But while new model launches and expansion of North American capacity to 1.4 million units continues to increase the dollars we spend – note that our base of suppliers is not growing at the same rate. In fact, it has stabilized. That doesn't mean that a supplier who is not currently selling parts to Honda has missed the opportunity. But it does mean that they must come to us with a unique value proposition.

Atlantic Tool & Die, based in Strongsville, Ohio, is a good example of a supplier that has consistently responded to challenges incumbent with our business. Their start with Honda was rather typical in that we began discussions in 1986 – and they started supplying us with small stampings two years later. Nothing about Atlantic stood out from other stamping companies in terms of their technological capabilities. But we recognized something in the spirit of this company. Their management philosophy matched ours'.

When our relationship began, I know they were surprised with how much time Honda management and staff spent in their facility. But Atlantic's management has been equal to the task ... always involved ... going to the spot on the shop floor ... and knowledgeable about their operations.

Atlantic has consistently added value to our business. Prior to working with Honda, their business was limited to stampings. Recognizing the priority we place on added value, they saw an opportunity in our rapid expansion in the late '80s. After just one full year with Honda ... and with no promises of additional business ... they invested in a major expansion of their original plant to handle weldments and assembly work. It was a big step for a small company. But it tripled their employment in just four years and led to a second plant in Ohio.

Two years ago, we challenged our supplier network to become more globally competitive. That doesn't mean everyone needs to look to Asia as a supply source. But it is difficult for small stamped parts to achieve global competitiveness in North America. Atlantic has made an ongoing commitment in this area. In fact, through our International Parts Center in Ohio, Atlantic parts are exported to Honda plants overseas. They now export more parts than were originally supplied to us. And this helped turn a company we came to know as a small Ohio tool shop ... into a global player.

Atlantic also took initiative to bring value to Honda in new model activity. Last fall, they began operations at a brand new facility in Alabama serving our plant in Lincoln. And they are currently in the process of launching some 25 new part numbers for the all-new Odyssey that goes into mass production next week. Earlier I explained how we support our suppliers by troubleshooting inside their facilities. This includes during the new model process ... where we conduct New Model Reviews that analyze a supplier's readiness for mass production.

For instance, despite our solid relationship with Atlantic, Honda associates have been in their Alabama plant, observing trial runs with mass production tooling. Together, we have determined countermeasures for areas of concern. Importantly, this process is addressing issues that otherwise could have occurred during mass production. This is another example of how going to the spot and working together are ongoing activities of a healthy relationship.

But the key is that Atlantic has done the basic things very well. Like many first-time suppliers, initially they were challenged by our quality expectations. But it only seemed to motivate them. In just their second year with Honda, they earned a quality award. And they have earned enough of them now that I am almost tired of visiting their plant for awards presentations.

Atlantic has now grown from \$7 million dollars in sales, with one Ohio plant and a handful of part numbers ... to \$70 million in sales, with four U.S. plants, and more than 250 individual part numbers directly to Honda or to our Tier 1 suppliers. Most of these are value-added parts and assemblies. And they continue to look at new ways to add value. Five years ago, they began investing in proprietary in-die sensor technology that reduced stamping errors by 90 percent in just the first year. This is another sign that they are poised to jump on new opportunities by keeping up with our expectations and goals.

And Honda's expectations keep going higher. We are committed to creating new value for our customers. This has profound implications both for our products and the operations that produce them. From a manufacturing perspective, we have set our sights on the next 25 years in North America. And this means even higher levels of quality, efficiency and flexibility.

For Honda, it is never enough to have quality as good as others. A case in point came with the release of the most recent IQS numbers. Honda was the number one non-luxury brand. But I can tell you there was not a single headline in America making that announcement. The story everyone wanted to write about were improvements by Hyundai or domestic brands like Cadillac. Don't get me wrong, I am not complaining about the news coverage. It just demonstrates clearly that media – like our customers – have higher expectations for Honda when it comes to quality. And we plan to exceed those expectations.

For the past five years, we have been introducing Honda's flexible New Manufacturing System on a global basis, including all of Honda's North American auto plants. This new system reduces tooling costs associated with new model launches. It increases launch speed and initial quality. And makes it quicker and less costly to add models to our plants. Already, we have achieved a great deal of flexibility for car and light truck production at our North American plants..

In May of this year, we began building a new paint facility at the Marysville Auto Plant. This major expansion will introduce waterborne paint systems that are already found at newer Honda facilities. And will go into full operation in mid-

2006. Along with other new paint systems developed by Honda, this is expected to reduce emissions by 41 percent and improve energy efficiency by 34 percent. These investments show how continuing to invest in manufacturing quality, efficiency and flexibility enables us to create new value for our customers.

I began today by talking about the importance of values to Honda. But I think a relevant question for all companies is “What are your core values? What makes your company unique or special? And does your self-image match reality?” If not -- to realize improvement -- you shouldn’t focus just on trailing indicator metrics. Focus on the characteristics that will lead to success in the future.

A supplier might get our attention with a very competitive price ... but they won’t necessarily get our business. We want suppliers with the whole package ... robust quality systems, delivery management and development capabilities ... who work in a respectful manner with their own workforce. When we visit a supplier and talk to their people, we can tell immediately how they do business.

Based on these years of going “to the spot,” we identified key characteristics of strong suppliers. We shared this “road map” earlier this year with our own supply base ... and I thought I would share it with you today. I am not going to review every detail. But I will explain several key areas. Similar to Honda’s business model, we found that company culture is an extremely important characteristic for successful suppliers. This includes strong leadership – top management that frequently goes “to the spot” to motivate and involve their associates.

The process really begins with a company vision focused on the customer. This has to be central to why you are in business. Based on a customer focus, the best suppliers are willing to take chances – to develop a new part or process ahead of others. In other words, to bring new value to their customers.

With a view toward achieving global competitiveness, is the need for suppliers to create new products that offer exceptional value to their customers ... something we cannot achieve on our own – or obtain from others. Early this year, as part of new model planning, we compared the total unit cost of all commodities and part types in North America to other regions. Analyzing current cost gaps revealed that a large number of suppliers in North America are not globally competitive. We identified production characteristics as one of the primary factors in this cost gap. Achieving global cost competitiveness will require innovation in this area.

Improving production characteristics begins with identifying the benchmark in your business ... then, assessing your relative position to that benchmark in order to determine your plans to exceed it. Suppliers also must innovate production facilities from dedicated lines to flexible lines to match the flexibility achieved by their customer. Look for other ways to reduce capital investment in equipment and tooling. And, compared to global benchmarks, suppliers must look for production efficiency improvements through your entire operations – and reduce waste by optimizing material yield, scrap reduction and inventory control.

After achieving global competitiveness, other essential elements of the road map include the need for advance planning for resource deployment including new model preparation ... the ability to execute to the plan in production ... and customer satisfaction – exceeding the buyer’s expectations – is the end goal.

But the real purpose behind the development of this road map, was our interest in looking ahead to the next 25 years of Honda’s manufacturing operations in North America. Our goal is to remain a brand of choice ... based on our ability to create new value for our customers. But to achieve that, we must make sure that the companies with whom we have chosen to have relationships – will remain “suppliers of choice” -- so that we can continue to create new value together.

This means suppliers must know the benchmark in their industry – and honestly identify any gaps to that benchmark ... as a means to achieve global competitiveness. Suppliers of choice also listen to their customers – making sure they understand their partner’s expectations . . . whether they are currently satisfied ... and where they most need support. These suppliers also listen to their associates ... because empowering people on the shop floor in continuous improvement activities is the key to achieving real and sustained improvement.

Suppliers must provide strong leadership and direction – management must “go to the spot” to monitor performance -- which means into the labs, onto the shop floor, and out to the loading dock. Every “touch point” to the customer must be closely managed. Finally ... underlying all of this ... is our belief that suppliers of choice understand the values that are most important to their business partners. And make certain their own corporate culture is well understood throughout their company and by their partners.

In this way, no matter how challenging the business environment may become ... suppliers and OEMs will have the type of rock-solid relationship that is not only mutually satisfying ... but has the strength to withstand a “perfect storm.” Thank you for your attention. I look forward to your questions.