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European Suppliers on the Razor's Edge

Falling prices and intense competition are turning the automotive supply industry into one of Europe's most competitive sectors, as documented by an Oliver Wyman survey. To date, most suppliers have been able to boost productivity every year and drive profitable growth. And the more globalized the suppliers are, the better their productivity gains. Globalization skills thus continue to be important, along with cost management and a customer orientation.

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European suppliers have transformed themselves into high-performance players in a global market, according to a study, "Automotive Suppliers – A High-Performance Industry" by Oliver Wyman and HypoVereinsbank, which is based on a comprehensive survey of top managers in Europe. These suppliers have been lowering their prices by an average 2.4 percent a year, while boosting their productivity by 3 percent and investing more than 5 percent of sales in research and development. As a result, European suppliers were able to increase sales by an average 3.4 percent a year between 2001 and 2006, in many cases accompanied by rising returns.

Although EBITDA margin remained unchanged at about 11 percent during this period, the

average return on equity rose from 2.4 percent to 5.3 percent, with operating earnings rising from 2 percent to 4.2 percent of sales. Although differences in performance are very low, growth rates within the sector diverged considerably: While the top 25 players managed to improve on all key indicators, the average total return on equity in the bottom quartile declined from 1.9 percent in 2001 to 1.4 percent in 2006, with operating earnings amounting to 1.2 percent.

Common success factors

The study sought to identify the key factors behind the business success of automotive suppliers, and found that the same factors apply irrespective of company size, business model, or scope of activities. The surveyed

managers report that long-term economic efficiency is the key factor as measured by operating earnings, cash flow, return on sales, and sales growth. “Soft” factors are also important at many companies, particularly employee satisfaction and job creation. More than 75 percent of the surveyed managing directors and management board members are even willing to forgo short-term optimization of their business success in

and say they will make their move only when automotive manufacturers actively demand globalization of suppliers.

Faced with continued globalization, new competitors from low-cost countries, as well as pre-financing requirements, warranty risks, rising material costs, and increasing product complexity, few suppliers see any margin for error – one surveyed manager called it

“Suppliers are like top athletes – success or failure can boil down to a hundredth of a second. Only companies that achieve top scores on nearly all success criteria will succeed.”

favor of these criteria. Other factors mentioned by respondents include customer orientation, an entrepreneurial approach, cost management, employee qualification, and strong innovation. Top companies in the sector rank above average on all these criteria.

The study highlighted a significant correlation between business success and customer orientation. The more that companies tailor their services to manufacturers’ and motorists’ needs, the more successful they are in the market. While the respondents think that they have successfully positioned their companies to meet manufacturers’ requirements, they are a long way from optimally serving the end consumer. At the moment, for example, only about 50 percent of all automotive suppliers conduct market research, and few R&D departments tailor their product strategies to end consumer priorities.

Developing low-cost offers

Future competitiveness depends on suppliers’ ability to boost productivity. To date, volume providers as well as module and system providers have achieved this best through plants in low-cost countries. However, many European suppliers say they are not able to develop cheap modules for emerging markets in Asia, America, and Eastern Europe. They acknowledge that the target price is a key metric and that production capacities must be set up to allow for the development of truly low-cost products.

Cautious about globalization

Suppliers themselves regard the gap between their current positioning and global market requirements as their greatest challenge. Most rate their own global coverage as merely satisfactory to good, while low performers acknowledge that they are badly positioned. Small and mid-sized companies, in particular, shun the high risks related to internationalization, and they fear that management resources would become overtaxed. As a result, they focus mostly on European locations

“rolling along the razor’s edge.” To date, however, the sector has managed to master the challenges it has faced and improved its own performance capacity. Suppliers know that they will have to improve their cost base and their global positioning in coming years if they want to continue to achieve profitable growth.

Six recommendations for automotive suppliers

- 1 Top performers should test all available means to permanently optimize their cost base. There must be no “sacred cows” when it comes to cost-cutting.
 - 2 European suppliers must extend their technology leadership in cooperation with the automotive manufacturers to improve both functions and costs.
 - 3 In the low-cost vehicle segment, the fastest-growing segment in automotive, low-cost modules, development capacities, plants in low-cost countries, and local sales resources must be set up, offering consistently high quality adapted to local specifications.
 - 4 Just like automakers, suppliers must consider their end consumers more closely by undertaking market research.
 - 5 Suppliers should look for suitable network partners and restructure their own organizations accordingly.
 - 6 A globalization strategy must be worked out independently or in cooperation with partners.
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