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It's time to act



## Red alert for suppliers

Suppliers are feeling the full force of the global economic crisis. Since November 2008, over 40 companies in German-speaking regions have filed for bankruptcy, and suppliers' revenue fell 35 percent in the first quarter of 2009. By the end of the year, 15 percent of the 7.4 million global jobs provided by automotive suppliers could be cut – areas outside of Germany will be particularly hard hit. The new automotive supplier study by Oliver Wyman and the German Association of the Automotive Industry (VDA) examines the current crisis, identifies countermeasures and explores the restructuring of the supplier industry.

Jan Dannenberg,  
Lars Stolz

Like a house of cards, new-car sales figures collapsed country by country within a matter of weeks. The downturn started in spring 2008 in the United States, moved to Japan by mid-2008, hit Europe in the autumn of last year and now has reached South America. The only bright spot has been China. For the new study »Continuing Crisis or Rebirth of the Automotive Supplier Industry?« a total of 120 CEOs from automotive supply companies in Europe, Asia and North America were surveyed. They think a drastic decrease in worldwide auto production will occur this year. Manufacturers around the world earned three billion euros from sales of new vehicles in 2008. With total revenue from new-car sales of 1.14 trillion euros, this corresponds to just 46 euros per vehicle.

### There is a lot to be done

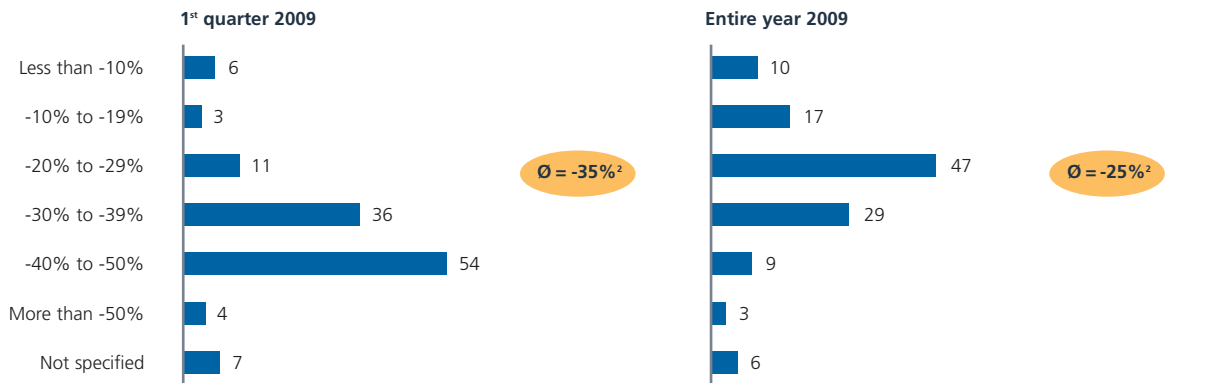
The cause of this dramatic collapse can be primarily traced to the financial market crisis. Since the crisis spread to the real economy, demand for new vehicles has plunged. The structural challenges of the highly consolidated sector are also intensifying the pressure on automakers (OEMs). With a global overcapacity of about 30 percent in typical years, the crisis has increased inventories, which has led to ruthless price wars for market share.

### Customers are unsettled

Product costs have increased rapidly because of the proliferation of models and options. Improvements in functionality also have made vehicles more complex to make. In addition, there has been a crisis in consumer confi-

## Revenue expectations for 2009

The surveyed suppliers<sup>1</sup> experienced a dramatic drop in first-quarter revenue but predicted better results for the rest of the year



<sup>1</sup> n = 121

<sup>2</sup> Unweighted

Source: VDA and Oliver Wyman study »Continuing Crisis or Rebirth of the Automotive Supplier Industry?«

dence. Besides the global recession, talk about alternative drive systems and the requirement to reduce CO<sub>2</sub> and other emissions in future models has made car buyers uncertain about purchasing a new car today.

### Nearly all experience losses

In the past six months, the crisis has hit automotive suppliers harder than OEMs. Company bankruptcies are a daily occurrence. In the United States, about half of the 30 largest automotive suppliers, which have revenue of about USD 270 billion and more than one million employees, face the threat of bankruptcy. This is a big change from the situation at the beginning of the crisis. In 2007, suppliers generated earnings before interest and taxes (EBIT) of 5.3 percent. Despite the downturn experienced last autumn, component manufacturers finished 2008 with a 2.9 percent increase in revenue and a positive EBIT margin of 4.3 percent. The initial devastating signs of the crisis appeared in the first quarter of 2009. Revenue at suppliers fell by 35 percent and nearly all companies experienced losses.

### No quick end in sight

Although some suppliers are more optimistic, the experts at Oliver Wyman forecast it will take until 2014 at the earliest for a return to the EBIT level seen in 2007. The ongoing decrease in sales volume and revenue is having devastating effects. Measures being used right now such as shorter workweeks are helping companies to briefly catch their breath, but they are not a long-term solution. For this reason, automotive suppliers are being forced to make significant structural adjustments to their cost structures. This can be done only through operational restructuring. The priorities must be setting up crisis and turnaround teams, implementing cost-cutting programs, streamlining portfo-

lios and lowering capital costs. If the market does not revive, layoffs, plant shutdowns and the sell-off of individual company segments will happen.

### Wave of consolidations is unleashed

But even if such steps are taken, bankruptcy will be unavoidable for some companies. The pressure from lenders is just too great. About 500 of the world's 4,000 automotive supply companies, each with annual revenue of more than 20 million euros, will declare bankruptcy by the end of 2010. In Germany, this could affect up to 70 companies. Many of those companies could remain in business following a restructuring. Suppliers owned by private equity firms find themselves in an extremely precarious situation as a result of their high amount of leverage and the interest rate payments associated with it. This is triggering a wave of consolidation and a market shake-up.

### Act immediately

To survive the crisis, companies must take fast, decisive action. In the last three to six months, the primary goal was to secure liquidity, said 96 percent of the surveyed CEOs. The focus through the end of 2009 is to advance the structural reorganization of the company within the context of comprehensive programs. It will not be until the beginning of 2010 that management will be able to consider the company's new direction over the middle term and introduce the necessary measures to improve competitiveness and to optimize market positioning.

The present situation calls for vigorous crisis management that facilitates quick decisions and institutes unconventional but direct processes. Payment goals are now being renegotiated, receivables collected, low-priority projects stopped and crisis-tackling task for-

ces formed. In terms of personnel and non-personnel costs, spending is being reduced without tapping cash reserves by dismissing temporary workers; discontinuing flex accounts; postponing pay raises; cutting bonuses and fringe benefits; and introducing a shorter workweek on a wide scale. The focus through the end of 2009 is to lower capital costs and to safeguard the availability of capital within the context of financial restructuring. Key steps include strengthening the equity base, optimizing cash flow and reducing borrowing costs. To reposition the business starting in 2010, the company's entire financial structure must be realigned.

#### Master plan ensures profitability

After implementing all measures to cut costs and reduce expenditures, structural issues must be addressed. As a result, the aim of operational restructuring is to adjust capacity, consolidate locations and implement sweeping cost-cutting programs in all areas. It will not be until the beginning of 2010, when the new mid-term direction is introduced, that structures can be trimmed down to meet competitive needs. Companies should focus entirely on their core areas of expertise and orient their operating activities toward them. This adjustment forms the foundation for the strategic realignment. In 2010, a new master plan should be launched that allows companies to profit from the crisis.

#### The cards will be reshuffled

Although the overall market will grow again in 2010, individual regions and market players will profit in different ways. Japan and the United States will become less important while China will develop into the new major power in the automotive industry. Europe has the ability to defend its position because of growth in the eastern European markets.

OEMs and suppliers must address the challenge of alternative drive systems and the increasing importance of sustainability. Despite all of its negative effects, the crisis will ultimately strengthen the supplier industry. Weak companies will disappear. Strong suppliers that have run into financial difficulties will be systematically acquired by competitors or investors. Through this process, new relationships of power will emerge. OEMs and suppliers will have to ask themselves how they will shape their partnerships in coming years. Will it be a »New Automotive Deal« or a weakening of the value-creation structure?

The public sector could play an important role in coming years. The surveyed top managers think that only healthy companies should qualify for loan guarantees and soft-loan programs. Any company that failed in recent years to run its business efficiently and competitively cannot expect now to receive help from taxpayers. Many market players have the opportunity to emerge from the crisis in a strengthened position and expect to see as little distortion of competition as possible along the way.

#### The winners from the crisis

Today's important success factors – customer focus, cost leadership and innovative power – will remain top priorities for companies. In addition, »soft« success factors such as skills in entrepreneurial activities, exploitation of globalization and strong network ability are becoming increasingly important. The current degree to which the factors are being met shows how well supplier companies are positioned today. Many market players have the opportunity to emerge from the crisis in a strengthened position and begin a further stage of growth.

## Recommended actions for suppliers

	Finances	Operations	Strategy	Management system
<b>Immediately stop the bleeding</b>	<b>Secure liquidity</b> <ul style="list-style-type: none"> <li>- Optimize liquidity forecast &amp; working capital</li> <li>- Stop spending/investments</li> <li>- ...</li> </ul>	<b>Cash and delivery capacity</b> <ul style="list-style-type: none"> <li>- Cut temporary workers and personnel (without cash out)</li> <li>- Negotiate new deals with suppliers, OEMs</li> <li>- Secure suppliers</li> <li>- ...</li> </ul>		<b>Crisis management</b> <ul style="list-style-type: none"> <li>- Form crisis teams</li> <li>- Try direct, unconventional processes</li> <li>- Make quick decisions</li> <li>- ...</li> </ul>
<b>Extensive restructuring (2009)</b>	<b>Loan costs and availability</b> <ul style="list-style-type: none"> <li>- Reduce borrowing costs</li> <li>- Bolster equity base</li> <li>- Improve cash flow</li> <li>- ...</li> </ul>	<b>Cost cutting</b> <ul style="list-style-type: none"> <li>- Adjust capacity and consolidate locations</li> <li>- Start cost-cutting programs for material, production, overhead</li> <li>- Secure suppliers</li> <li>- ...</li> </ul>	<b>Portfolio adjustment</b> <ul style="list-style-type: none"> <li>- Focus on innovations, products, projects, sales network, customers</li> <li>- Seek M&amp;A chances (opportunistic)</li> </ul> <b>Business takeover from competitors in distress</b>	<b>Management restructuring</b> <ul style="list-style-type: none"> <li>- Create transparency in market and individual situation</li> <li>- Prepare scenarios</li> <li>- Develop options</li> <li>- ...</li> </ul>
<b>Mid-term redirection (2010/11)</b>	<b>Solid financial structure</b> <ul style="list-style-type: none"> <li>- Realign debt structure</li> <li>- Strengthen equity base</li> <li>- If necessary, examine ownership structure</li> <li>- ...</li> </ul>	<b>Competitive cost structure</b> <ul style="list-style-type: none"> <li>- Improve footprint</li> <li>- Optimize sourcing</li> <li>- Focus on core areas of expertise</li> <li>- ...</li> </ul>	<b>Sustainable profitability</b> <ul style="list-style-type: none"> <li>- Focus on products, markets, customers, technologies</li> <li>- Seek M&amp;A (targeted)</li> <li>- Seek partnerships and networks</li> <li>- ...</li> </ul>	<b>Traditional management system</b> <ul style="list-style-type: none"> <li>- Return to management system »sustainable business development«</li> <li>- Learn lessons from the crisis</li> <li>- ...</li> </ul>