M A N A G E M E N T S U M M A R Y

Oliver Wyman study on the automotive supplier sector: “The supplier industry caught between cost pressure and value growth”

Stamp out losses!

- **Price pressures maintain their stranglehold on the automotive supplier industry**
- **Volume growth and innovations offer only selective growth opportunities**
- **Cost downs and globalization are imperative**

Enormous cost pressure is weighing on the entire automotive industry. Suppliers, responsible for more than 50 percent of value creation, are feeling most of this pressure. For the new Oliver Wyman study “The supplier industry caught between cost pressure and value growth,” a worldwide survey of managing directors and board members at leading automotive supplier companies was conducted in the first half of 2010. The survey results show that cost pressures in the industry will intensify further in future years and that functional innovations can play only a very limited role in offsetting this trend toward loss of value. The only recourse that suppliers have to generate long-term value gains and profitable growth is global growth in volume following the crisis – particularly in emerging automotive markets. In the highly competitive supplier market, the only companies achieving sustainable success will be those that are internationally focused, are located in emerging markets and generate significant cost downs.

Automotive suppliers must carry the largest share of cost downs in the value chain. After all, the parts provided by suppliers are automakers’ biggest cost item. As a result, suppliers are subject to unsparing and unrelenting cost pressure, which has been intensified even further by the latest crisis in the automotive industry. The results of the Oliver Wyman study “The supplier industry caught between cost pressure and value growth” show that the trend will continue. In a reflection of this, suppliers say OEMs will strive to achieve average price reductions of 4.3 percent annually over the next five years. The average price cut that is actually achieved is 2.5 percent.

Value losses despite functional improvements

The continuing loss in value suffered by the supplier industry is picking up additional momentum because functional improvements made at the beginning of a new product life cycle can provide only limited help. It is true that specialized component producers working in a niche have the opportunity to generate profitable growth in their segment. Overall, though, suppliers can push through price increases at OEMs only rarely. The study found that functional innovations and growing equipment rates offset the value losses on an average vehicle for only

20 percent to 30 percent of vehicle modules, while 70 percent to 80 percent is subjected to merciless cost pressure.

The cost pressure affects not only the most modules, but also all vehicle segments – from low-cost to premium. As a result, suppliers must expect the price pressure to intensify among German premium brands as well. The Oliver Wyman study shows that the cost-down requirements of premium OEMs will continuously rise, reaching the level of volume manufacturers in years to come.

Lowering costs

Given the relentless cost pressure in the automotive industry, costs are becoming the No. 1 competitive factor for suppliers. If suppliers are unable to get a handle on their costs, this will result in lower margins and, in the end, reduced profitability.

The Oliver Wyman study provides suppliers with two approaches to lower their costs under these business conditions: First, suppliers must more forcefully apply proven levers in procurement, product-cost reduction and production optimization. For this purpose, programs designed to systematically optimize the product costs of current and future series can be applied jointly with procurement, development and suppliers. Second, suppliers must be innovative and develop materials, technologies and designs that have a better cost profile. In the process, the suppliers' innovative energies should be directed at process optimization and cost innovations.

Global focus needed

The volume growth following the crisis creates an opportunity for suppliers to begin increasing value and generating profitable growth once again. Costs per vehicle will indeed fall by about 2 percent annually in years to come. But, as a result of the roughly 6 percent annual rise in post-crisis vehicle sales that is forecast for the entire market over the next five years, the overall supplier market will grow by 4 percent annually.

In regional terms, though, the growth in volume will be very disparate. While saturated markets like Western Europe, Japan and the United States may return to pre-crisis levels at best, growth markets like India and particularly China have been producing average growth rates of nearly 10 percent since 2007. Only those companies with an international focus on cost efficiency and the necessary production-capacity presence in the important growth markets will be sustainably successful in the highly competitive supplier market.

Five success factors for the future of the automotive supplier industry

1. **Cost Management and Value Growth:**

   Focus on product cost reduction, implementation of lean organization and footprint optimization as well as cutback of overcapacities

2. **Strategy and Portfolio Alignment:**

   Focus on value generation; drop business activities that do not generate value

3. **Innovation Management:**

   Focus on value-generating innovations and cost-driven adjustments in the innovation portfolio

4. **Sales Management:**

   Incentive system adjustment and professionalize sales in price-negotiation situations

5. **Behavior and Leadership:**

   Concentrate on the achievement of business goals and focus individual's performance excellence, foster turnaround & restructuring mentality