

OUTLOOK FOR THE NORTH AMERICAN AUTOMOTIVE SUPPLY BASE

Most auto suppliers are now earning solid profits. But how can they maintain current cost efficiencies while expanding to meet growing vehicle production schedules? The keys, according to the Original Equipment Suppliers Association, will be product and process innovation, “smart” consolidation and continuous cost improvement.



Neil De Koker

OESA President and CEO Neil De Koker explains those conclusions and other findings of *The Future of the North American Automotive Supply Base* survey conducted for the organization earlier this year by McKinsey & Co.

What is the industry’s biggest worry now?

A big challenge is guaranteeing the long-term viability of the supply chain. Suppliers provide 65%-70% of a vehicle’s content, so a healthy supply chain is critical.

The greatest concern is about the tier two, tier three and tier four suppliers. Many of these companies are privately held, and it’s a challenge to determine their financial health. They tend to have less access to funds, especially for asset-based loans. A failure in that portion of the supply chain could shut down the entire industry. But it can be difficult to get a clear picture who supplies whom at the sub-tier level. You have companies making parts that go into a subassembly that another company uses to create a more complex component that third company uses to produce an assembly for an OEM.

Tier one suppliers don’t necessarily want to go public with who their suppliers are. But they are very aware that they must be responsible for assuring the capability of their own supply chain to meet their responsibility to OEM customers.

There’s been lots of discussion about this, especially after the earthquake disaster in Japan and massive floods in Thailand. The carmakers can’t dictate, but they can ask their suppliers to become more flexible. They want suppliers who can quickly adjust if a plant goes down. The OEMs want to save money on consolidated production, but not if the risk is too high. Minimizing risk is becoming a standard way of doing business.

What is the outlook for production growth over the next few years?

The analysts say North America, barring a worsening of the crisis in Europe, will produce around 12.9 million units this year, about 13.5 million in 2012 and perhaps 14 million in 2013. We won’t get back to the old 16 million-unit production volumes for several years.

Lots of capacity has been taken out of the entire industry, and nobody wants to go back to the 30%-40% overcapacity we had a few years ago. Instead of producing too many cars and then forcing their sales, we have shifted to a pull system driven by consumer demand. Breakeven points are well contained, and the industry is cautious about over-investing or over-hiring.

Will that condition continue as the industry expands again?

I think so. It was a very painful change to have two of your three domestic OEMs and 61 major suppliers restructure, about 200 suppliers exit the business and lose more than 300,000 jobs. We’re *not* going to become fat, dumb and happy with this current generation of executives.

What should suppliers do next?

Our survey says suppliers must be smart about how they expand. We’ll see more collaboration among these companies. OEMs do this now, of course, but suppliers will need to do the same to gain results they can’t achieve themselves. The OEMs recognize they need to do a better job of keeping suppliers informed and maintaining more consistent production schedules to help control costs.

There’s tremendous pressure on cost, and that is something that will be with the industry forever. As the supply base consolidates in North America, we’ll gain more suppliers from overseas, so competition will continue to grow.

Suppliers need to be innovative in their products, processes or both. Suppliers also should be ready for competition from “adjacent” areas, meaning companies from outside the traditional auto industry. Light-weight materials developed for the aerospace industry is a good example. Similarly, the proliferation of powertrains and sources of fuel—including electricity—will bring competition from new sectors.

Is it still difficult for suppliers to access capital?

It’s not nearly the hurdle it was a few years ago, but it’s still a challenge. The healthiest suppliers can generally get what they want. Valuations in the auto industry are significantly higher than they were in 2008 and 2009. That means private equity isn’t as interested in investing, because the opportunity for big returns has passed. Banks are more willing to lend, but the industry is stuck with asset valuations that are low by historical standards. Suppliers generally get loans based on the valuation of their assets, which makes less money available from lenders.



Do you expect further consolidation in the supply base?

There will be some, but the pace continues to be slow due to limited financing. A strong wave of consolidation began in the recession a few years ago. Many companies that were cash-rich were able to buy assets from failing companies, gain business and realize an immediate gain.

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