

## **The Current State of Commercial Relationships**

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As we prepare to conduct the seventh biennial IRN survey on price reduction requests, we have some theories and some questions about what the results will reveal. The context has certainly changed since our last survey of the supply base in 2007. North American light vehicle production that year was 15 million units. US sales were 16.1 million. Not to get all moist-eyed and nostalgic, but things were pretty good! Even in terms of pressure for price reductions, the 2007 survey results were somewhat encouraging. The average percentage pricelown requested by customers had declined significantly to 4.6%, and component suppliers were coalescing around an average figure of 2% as a doable giveback. DaimlerChrysler and GM, the most aggressive customers in the 2005 survey, had mellowed out, leaving Ford and some Tier Ones as "Most Likely to Strong-arm the Supplier."

In 2009, the bottom fell out of the economy, and the auto industry. We are looking at a likely NA production of slightly over 8 million units and US sales around 9 million, in rough numbers. The year-over-year decline of production has been a much bigger issue for suppliers than the latest price reduction program. In this environment, we certainly expect this year's survey to show that most suppliers are in a weaker financial position than they were two years ago.

Anecdotal evidence has suggested some potentially positive dynamics, however. Necessity has been the mother of very effective cost-cutting for a number of companies, and almost all of our clients have accomplished this without resorting to Chapter 11. Some companies have told us that they have been able to reduce their cost structure by figures as high as 40%. Workforce reduction has been a common method, but we will be interested to learn more about the measures suppliers have been taking, and what degree of cost improvement they expect to retain as production volumes go back up. A survey this summer by the Original Equipment Suppliers Association asked its members what their current breakeven point was, as measured in NA vehicle production. Over half of the survey respondents said they could now make money at 10 million units or less. This is an amazing improvement in a short period of time, given that most suppliers had a hard time breaking even at anything lower than 14 million units not too long ago. As the industry starts to really recover in 2010, this indicates that the majority of the supply base will return to profitability.

In addition to responding to extraordinary times by achieving dramatic cost improvement, there are also suppliers who have been making up lost ground by capitalizing on the weaknesses of others. One of our clients, for example, a significant player in its field and in decent financial shape due to conservative policies, has been able to win substantial takeover business with Ford at the expense of a supplier that did not inspire confidence in its supply chain performance. Contrary to the way the media makes it sound, this is not just an environment of losers, but one of winners and losers. We expect to find more examples of companies that are carving relative success out of these difficult times.

The heart of the IRN survey, and the reason for its creation in 1997, has always been the issue of customer demands for lower prices on everything from the job you are quoting on today to the programs you have already been running. Over the past twelve years, this dynamic has gone from being an unexpected wrench in the works to a predictable pattern. External factors, such as volatility of raw material prices, and the inventiveness of customers in conceiving of new programs and conditions (referred to in certain circles as 'weasel wording') have introduced new wrinkles from time to time. New questions in this year's survey to reflect what we have been seeing in 2009 should help illuminate the latest dynamics. They include the following:

- How have suppliers been dealing with long-term agreements, given the volatility in the industry? An LTA has historically assumed a stable external environment, so it is hard to see how it can be negotiated without knowing what is ahead for the industry on a very fundamental level.
- Have suppliers been successful getting price increases on existing business in light of the extremely low production volumes? We have started with the premise that pricedowns are the norm, but some suppliers have suggested that this may be an incorrect assumption.
- Has the cost to serve customers risen in different ways? We are seeing indications that, while price reduction requests may be less stringent, customers are introducing other requirements that work to their financial favor.
- Are suppliers getting engineering, tooling, and capital funding in different ways than previously? For example, some suppliers have apparently been successful in getting separate payments for engineering and tooling in the current environment, vs. piece price only.
- What changes are suppliers seeing in the competitive landscape? Instances of liquidation have been reported in the press. Companies that have experienced growth through takeover business can speak to the degree of consolidation happening in their product areas. Whether there will be as much downsizing of the supply base as some have predicted remains to be seen. As one of my colleagues says, "Some of these companies you can't kill with an elephant gun!"

We look forward to reporting on the results of these and other concerns facing the supply base. For more information, or to participate in the survey, please visit our website, [www.think-irn.com](http://www.think-irn.com).