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STRAINED RELATIONSHIPS WITH SUPPLIERS COSTING GM AND FORD

GM's supplier relationships at 15-year low; Chrysler shows improvement

BIRMINGHAM, Mich., May 31 — According to an annual study of automaker and auto supplier relationships, General Motors' relations with its suppliers are at an all-time low, Honda and Toyota continue at the highest levels while the gap between Ford and GM on the bottom and Honda and Toyota at the top continues to widen year over year.

Chrysler, however, showed continuing improvement in this year's study, while Nissan ranked the same as last year with positive relationships continuing after bottoming out in 2002 during a period of tough and somewhat adversarial cost-cutting. Ford's supplier relations continue very low and remained virtually unchanged in 2005.

The result is that suppliers are shifting more resources to the Japanese automakers at the expense of the U.S. Big Three.

"This year's study shows that suppliers are continuing to shift capital investment and research and development funds to their Japanese customers and decreasing somewhat their investments in the U.S. Big Three," said John W. Henke, Jr., Ph.D., whose Birmingham, Michigan-based firm, Planning Perspectives, Inc. conducts the annual study.

More than 250 Tier 1 suppliers participated in the 2005 study, which included 38 of the top 50, and 84 of the top 150 suppliers as ranked by Automotive News.

The shift in resources and investment to the Japanese automakers is not a new phenomenon. It began to show up in the 2003 study, continued in 2004 and is accelerating this year as U.S. automakers continue hammering their suppliers for price reductions, multi-million dollar cash givebacks and generally disregard supplier contracts.

In fact, according to one aspect of the study which compares OEMs' emphasis on cost vs. quality, suppliers say that for all the U.S. OEMs' talk about quality, GM is five times more focused on cost than quality, Ford and Chrysler four times, while Nissan is 2.5

times, Honda two times and Toyota only 1.5 times when selecting suppliers. The lower the number, the more the OEM balances quality with cost.

It is important to note, however, that this shift in loyalty and resources is not driven by cost reduction pressure on suppliers, says Henke, because both the U.S. and Japanese automakers are putting considerable pressure on their suppliers to reduce costs.

Rather it's based on how the US automakers treat their suppliers as measured across 17 business practices which are the basis of Planning Perspectives' Working Relations Index (WRI). These include factors such as supplier trust of the OEM , the OEM's open and honest communication with suppliers , OEM providing timely information to suppliers, degree of help the OEM provides the supplier to reduce cost or improve quality, OEM excessive and late engineering changes, early supplier involvement in the OEM product development process, the OEM giving the supplier some means to recover costs on cancelled or delayed programs, and suppliers' ability to make an acceptable return over the long term on the OEM's business, among other criteria.

"The study shows, again this year, that the US automakers' primary orientation is toward cost reduction, they have little regard for their suppliers, they communicate very poorly and they generally treat suppliers as adversaries rather than as trusted partners," said Henke.

"You could say that Ford and GM treat suppliers as if they were their private banks with unlimited funds to withdraw, and it is this attitude that is forcing suppliers to move resources to other automakers where they have the opportunity to make better margins. The reality is that GM and Ford are mortgaging their futures with their respective suppliers."

Henke says that GM and Ford have comparatively worse relationships with their suppliers than companies in any other industry his firm studies, while Honda and Toyota have the best.

"Each year, we study companies around the world in a variety of industries including automotive, food processing, aerospace and defense, computers, and power tools, and no one treats their suppliers as poorly as the U.S. automakers do – especially General Motors. GM simply fell off the chart this year – and their 'trust' rating by suppliers is at an all-time low."

As a result of their respective handling of suppliers, there are some profound shifts going on in the industry that can't help but impact Ford and General Motors profitability and ability to compete going forward, said Henke. These changes are summarized in the following points:

- Ford and GM's supplier working relations are falling behind Honda and Toyota at an increasing rate
- Suppliers continue to shift resources (capital, R&D expenditures, service and support) to the Japanese Big Three, while reducing these for Domestic Big Three
- Suppliers are working to increase product quality for the Japanese, while merely maintaining quality levels for US automakers
- Supplier trust of Ford and General Motors has never been lower; conversely, trust for Toyota and Honda has never been higher
- Suppliers increasingly see the opportunity to make an acceptable return as being with the Japanese automakers, not with the US automakers
- Suppliers overwhelmingly prefer working with Honda and Toyota

TABLE 1

Criteria	US Big Three	Japanese Big Three
Protect confidential info	Little regard for suppliers' proprietary information or intellectual property	High regard
Open, honest communication	Indifference; incomplete and late information.	High level, timely
Importance of cost vs. quality & technology	By far, primary focus is on cost	Also seek low cost, but balance it with quality improvements and technology
Supplier survival	Little regard	Concern for long-term success and stability
Relationship orientation	Adversarial; focus is on cost and OEMs' short-term gain	Strategically integrate suppliers into partnership-like relations

The study shows that the domestic Big Three and Japanese Big Three have fundamentally different approaches to working with their suppliers and suggests that this difference might well be a major factor in the consistently high quality and competitive gains by the Japanese. In fact, according to the study, in the five key areas measured – Relationship, Communication, Help, Hindrance, and Profit Opportunity -- the US automakers are 180 degrees opposite their Japanese counterparts. (See Table 1)

It is also why US suppliers continue to prefer doing business with the Japanese, and in some cases would like to drop the US automakers if they could.

According to the study, 85% of GM suppliers characterize their relationship with GM as being poor and 53% of suppliers would "prefer not to do business" with the automaker or are "ambivalent" about it, whereas 63% of Honda's and 73% of Toyota's suppliers consider these automakers "very preferred" or "most preferred" customers.

The overall results of the annual study are summarized by an annual ranking called the OEM-Supplier Working Relations Index (WRI). The WRI quantifies the working relationship suppliers have with their OEM customer on the basis of 17 different measures. The 2005 WRI shows the Japanese automakers continue to move up the scale toward even better relations with their suppliers, while the US automakers remain static at the bottom.

Again in 2005, the Index shows Toyota and Honda far ahead and ranked at 415 and 375 respectively, while GM and Ford are at the bottom with a ranking of 114 and 157 (see Table 2). Nissan was ranked 298, and Chrysler was 196.

The 2005 WRI shows that Toyota improved its position over 2004, while Honda and Nissan were about the same but still well above the industry mean. However, Ford and GM are well below the industry mean and are losing ground. Chrysler was also below the industry mean but improved again in 2005.

"It's important to note as well that the industry mean rose 15.6% over the four-year period driven by gains made by the Japanese Big Three," said Henke. "In other words, the Japanese OEMs keep raising the bar in the area of supplier working relations and are increasing the gap between themselves and the domestic Big Three.

"What is apparent is that the Japanese OEMs are applying continuous improvement practices to their supplier working relations just as they have done to their manufacturing processes, and as a result they continue to win the cost-quality-technology race."

Table 2. Overall OEM – Supplier Working Relation Index for 2002 – 2005. The Index ranks OEMs based on 17 criteria across 5 broad areas – Relationship, Communication, Help, Hindrance, and Profit Opportunity.

OEM	YEAR 2005				2004-2005 % Change	2002 - 2005 % Change
	2002	2003	2004	2005		
Toyota	314	334	399	415	4.0%	32.2%
Honda	297	316	384	375	-2.3%	26.3%
Nissan	227	259	294	298	1.4%	31.3%
Industry Mean	**224**	**234**	**261**	**259**	**-0.0%**	**15.6%**
Chrysler	175	177	183	196	7.1%	12.0%
Ford	167	161	160	157	-1.9%	-6.0%
GM	161	156	144	114	-20.8%	-29.2%

The 2005 study involved analyzing OEM-supplier relations across 1,112 buying situations and ranked the OEMs in five areas that comprise 17 variables. Based on this analysis, the U.S. automakers are well below the industry mean, with GM coming in far worse than ever before, while the Japanese Big Three are well above the industry mean with Toyota continuing is annual gains.

"Notably, the price reduction demands an OEM makes on suppliers has zero impact on the WRI. Rather, it is the *total* working environment of the OEM that impacts the WRI," said Henke.

"It's clear from comparing our past rankings with the 2005 results that Ford and GM have done virtually nothing to change their working relations with suppliers over the past four years, while the Japanese Big Three continue to improve."

The results of the survey also indicate why OEMs with good supplier working relations gain a competitive advantage.

"Over the years, we have seen a consistent pattern that shows OEM working relations directly affects supplier behavior. Our studies show that the further up the Index an OEM moves, the more suppliers are willing to help the OEM. Suppliers will share more technology with the OEM, are more willing to invest in new technology in anticipation of new business, and will provide higher quality goods and higher levels of service to the OEM.

"The Japanese OEMs clearly understand this and it's helping them gain competitive advantage and market share," he said.

The 2005 supplier survey was conducted in March and April. This year, it involved responses from 259 Tier 1 suppliers including 63 of the Top 100. The participating suppliers' combined sales represent 51% of the OEM's annual purchase of components.

Copies of the overall study, as well as more specific in-depth reports on each OEM and purchasing group, may be ordered by contacting Planning Perspectives, Inc., in Birmingham, MI. For information, phone +01.248.644-7690.

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About PPI

Since 1990, PPI has specialized in developing and implementing in-depth surveys of suppliers for the automotive OEMs and Tier 1 suppliers. In 2001, PPI initiated its syndicated Annual North American Automotive Tier 1 Supplier Study. These studies have become benchmarks for the industry and provide critical sales and financial planning information for suppliers and their sales, marketing, and financial staffs, as well as a means by which OEMs and their purchasing staffs can get a reality check on their working relationships with suppliers. John W. Henke, Jr., Ph.D. is president of Planning Perspectives, Inc., and is a marketing professor at Oakland University in Rochester, MI. PPI is based on Birmingham, Michigan and can be reached at +01.248.644.7690

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