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Automakers are Making Record Profits Now – but Suppliers Hold the Keys to OEMs' Future, Study Reveals

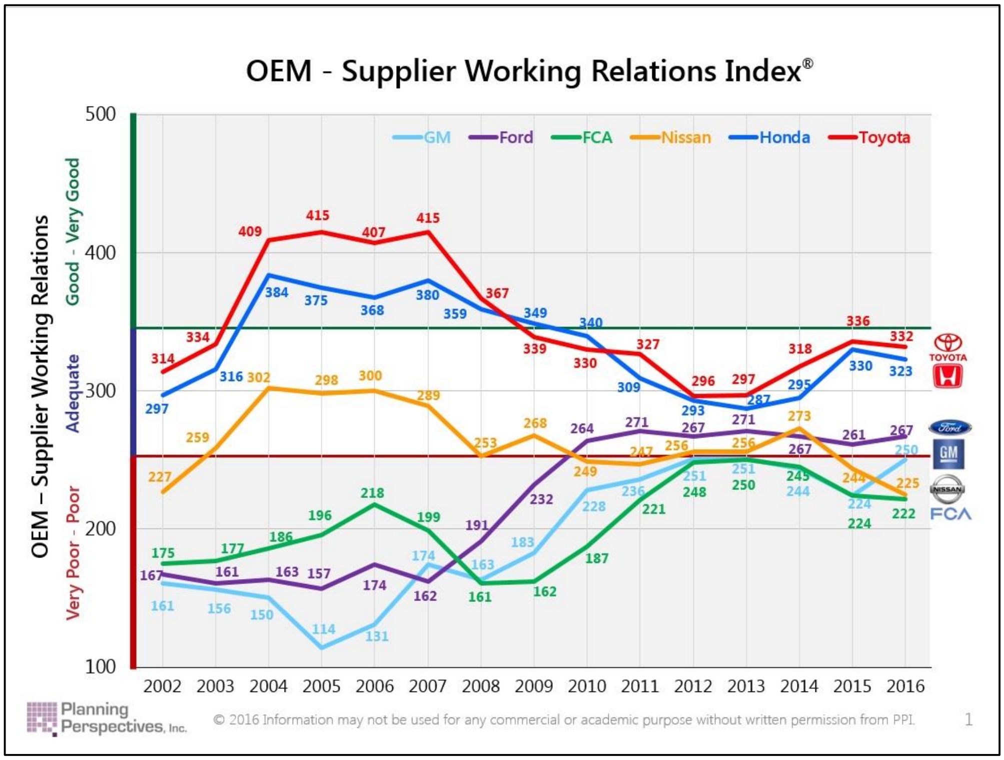
Detroit, May 16, 2016 – While the automakers are making record profits, they're also facing unprecedented financial challenges presented by new technologies, societal changes, government regulations and increased competition, all of which will require historic levels of capital investment to remain competitive. And, in spite of the current boom, many industry analysts expect auto sales to drop in 2018 – 2019, which will reduce revenue.

These same analysts agree that if the automakers are going to meet these financial challenges the automakers will have to work more closely with their suppliers to be successful because they are heavily dependent upon suppliers, spending 70-80% of their revenue on parts, components and materials provided by their suppliers.

"Going forward, automakers will have to invest heavily in new resources and training programs to improve their working relations with suppliers because suppliers have a significant impact on an automaker's profits," said John Henke, president of Planning Perspectives, Inc. "Currently this investment isn't happening with sufficient focus across the OEMs."

That's the conclusion of Planning Perspectives' 16th Annual North American Automotive OEM - Supplier Working Relations Index® Study which evaluates and ranks Ford, General Motors, FCA, Nissan, Toyota and Honda on their working relations with their suppliers.

The study shows that of these six automakers, only General Motors – a historical laggard – showed significant improvement in this year's study gaining 26 points in its Working Relations Index® (WRI®) and moving up to fourth place in the rankings by displacing Nissan, which dropped 19 points to fifth. Nissan and FCA now significantly lag the other OEMs. Ford improved by six points, but continues to significantly lag the two traditional leaders -- Toyota and Honda. Both of these Japanese automakers had shown significant improvement over the past two years, but this year dropped four and seven points, respectively.



"At a time of record profits when the automakers should be investing in building more collaborative relations with their suppliers, the major indicators of this year's Study suggest this isn't happening," said Henke.

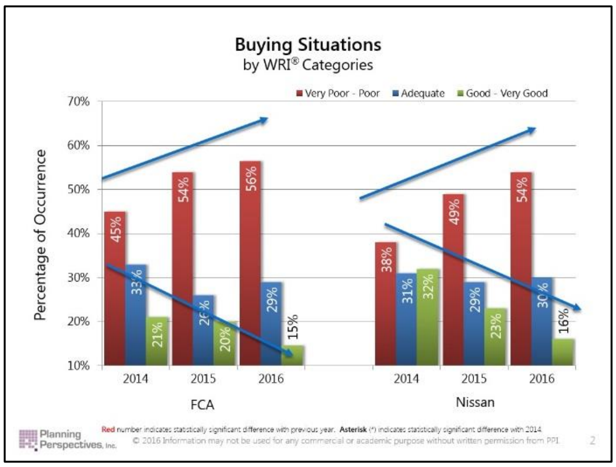
"We had expected Toyota and Honda to keep improving into the Good-Very Good WRI® range, but their several years of improvement seem to have halted. Ford supplier relations have been stagnant since 2010, bouncing back and forth in the low Adequate range. Nissan relations have dropped significantly during the past two years to being just ahead of FCA, which has been in last-place since 2008. The only bright spot this year is GM – they improved significantly -- up to the low Adequate status where they were three years ago."

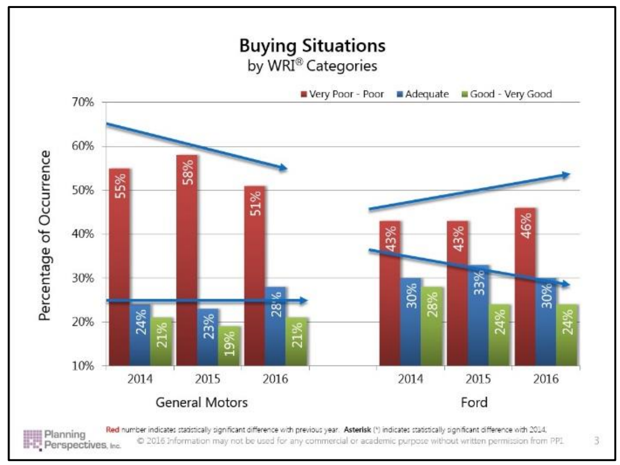
The study is watched carefully in automakers' boardrooms because an OEM's supplier relations rating is highly correlated to the benefits that a supplier chooses to give an OEM – including which OEM is first to see a supplier's newest technology, is provided a supplier's best personnel for support, and gets their best pricing – all of which impacts an OEM's competitiveness and the suppliers' contribution to the OEMs' operating profit, said Henke.

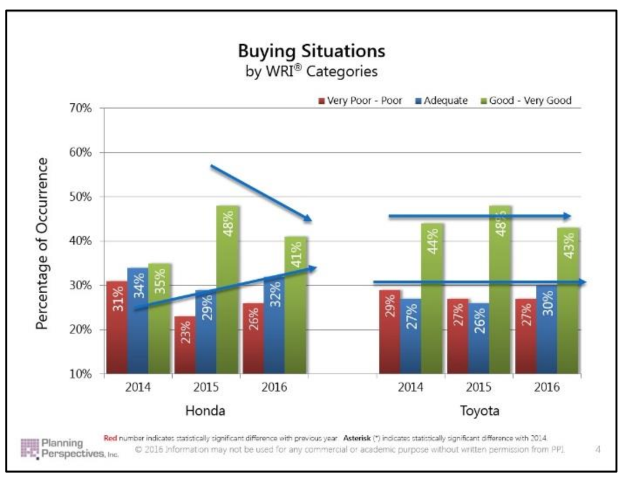
Key Indicators: Trending flat to negative

The annual study evaluates the relations between the OEMs and their suppliers. Over the years the study has shown that automakers must have certain relations-related characteristics in their purchasing organizations in order to build more collaborative relations, which lead to greater profits. The problem as Henke sees it is that these key characteristics have been flat or declining for several years for nearly all of the automakers, including GM, in spite of its improvement this year.

Nissan and FCA are ranked in fifth and sixth place respectively on the WRI® and are on trajectories that don't bode well for either company, said Henke. For both, the percentage of buying situations the suppliers rank as being Very Poor – Poor (red bars) is increasing, while the percentage ranked Good – Very Good (green bars) is falling – and has been for several years.







At GM, while Very Poor – Poor buying situations are declining somewhat, Good – Very Good relations are flat, with improvement only in the Adequate range. At both Honda and Ford there's a slight increase in the Very Poor – Poor ranking and a decline in the Good to Very Good. Toyota is essentially flat in both buying situation categories.

"Overall relations at Nissan have been essentially flat since 2008, followed by the significant drop of the past two years, while Ford relations have been flat with very little improvement since 2010," said Henke. "The flat Toyota and Honda relations this year are somewhat surprising given their steady improvement since 2013. We had expected both to continue improving into the Good – Very Good category where neither has been since 2009. These results suggest change is needed by all six automakers if future challenges are to be successfully met," said Henke.

Purchasing Area Volatility

The lack of progress in improving supplier relations becomes more evident when the relations for each OEM are considered at the Purchasing Area level. Even improvements at the traditional industry leaders in working relations – Toyota and Honda -- are stagnating as the table below shows. This past year Toyota improved in three Purchasing Areas while dropping in three, and Honda dropped in five out of six. Ford and FCA improved somewhat in three Areas, but dropped in three others. Nissan dropped in all six areas. Only GM showed meaningful improvement in its Purchasing Area performance – five of six Areas improved.

Purchasing Areas
Change in 2016 WRI® Relative to 2015 WRI®

OEM	Purchasing Area[1]						
	Body-in-White	Chassis	Electrical & Electronics	Exterior	Interior	Powertrain	Range in WRI Differences
Toyota	21	14	-89	-16	33	-29	122
Honda	-30	-5	-13	-56	30	-5	86
Ford	-23	4	31	-19	-4	20	54
General Motors	-5	19	32	42	42	17	47
Nissan	-83	-10	-15	-22	-6	-45	77
FCA	25	17	-39	26	-9	-20	65

[1] Red number indicates amount of drop in Purchasing Area WRI® relative to 2015
Green number indicates amount of increase in Purchasing Area WRI® relative to 2015

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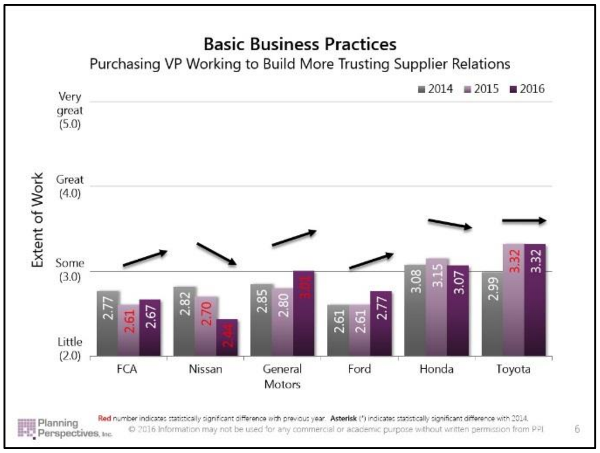
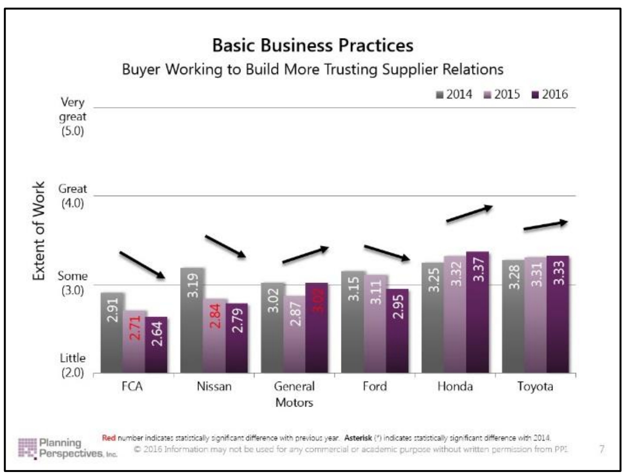
The range of difference between the highest and lowest rated Purchasing Areas in each OEM further suggests that disparate approaches are being taken by mid-level purchasing personnel within each OEM in building more collaborative supplier relations.

OEMs Building Trust – Mixed Results

One of the most important measures of OEM - Supplier relations is trust, said Henke. As in any relationship, it is the foundation upon which everything else is built. Both the Purchasing VP and Buyers must be committed to this effort. However, when it comes to actively building more trusting supplier relations five of the OEMs show disappointing results.

The charts show that the Purchasing VPs at GM and Ford have improved this year in working to build more trusting relations with suppliers. However, Buyer rankings in this area at Ford, as well as FCA and Nissan, have been declining for the past several years. Only the Buyers at GM are considered by suppliers to have improved.





More importantly, said Henke, only GM's Purchasing VP and Buyers appear to be working together to build trusting supplier relations. At FCA, and particularly at Ford, the Purchasing VPs are perceived by suppliers to be working to build more trusting relations but their Buyers are not. This suggests the mid-level Purchasing managers are not conveying the VPs' expectations down to lower levels and eventually to the Buyers. Even Toyota and

Honda have to focus more on this activity if they are going to be prepared for the challenges of the future, he noted.

"The Purchasing Area volatility, coupled with these less than coordinated efforts to build more trusting supplier relations suggests the automakers' purchasing executives may have taken their eye off the ball," said Henke. "More needs to be done at every level by every Purchasing VP. For example, we know that investing in the training or retraining of Buyers – who are key in building collaborative working relations – works; that's how Toyota and Honda turned around their relations ranking in 2013."

More Collaborative Relations – Greater Supplier Contribution to OEM profits

The automakers – and most companies – despite statements to the contrary continue to believe that beating up suppliers for price reductions leads to greater profits. But it's not true, says Henke.

"Oftentimes, when companies are in financial trouble or want to improve their profits, they turn to squeezing suppliers for price reductions in the belief that this will help the company's bottom line. Our studies over the years have proven conclusively this is not only the wrong approach, it is an approach that destroys supplier relations. Strong, profitable industry-leading companies are those with the strongest, collaborative supplier relations. OEMs cannot simply focus on supplier price reductions if they expect to get the best from their suppliers."

Data from this year's study substantiates this claim (NOTE: Each year's Study reflects the suppliers' prior year's experiences; e.g., the 2016 Study reflects 2015 experiences).

The table below compares Nissan and GM, and shows that Nissan in 2014 and 2015 has been increasing pressure on suppliers to reduce prices (Row-1). While price reduction pressure itself does not impact supplier relations, said Henke, the increased pressure was accompanied with increasing threats to reduce business or fear of retaliation if the concession was not given (Row-2) and now stands at 33 percent. At the same time, Nissan's WRI® dropped significantly from 2013 to 2015 (Row-3).

"These occurrences, plus other negative characteristics such as the Nissan VP and Buyers dropping significantly in building trusting relations, suggest that Nissan took a very aggressive adversarial approach to getting price concessions from suppliers," said Henke. "However, things didn't work out as planned. Nissan's aggressive behavior caused supplier buying situations experiencing Very Poor – Poor relations to increase dramatically in 2014 and 2015. As relations worsened suppliers reduced their price concessions which resulted in a lower price concession contribution per vehicle in 2014." (Row-4).

"In addition, suppliers pulled back in providing Nissan non-price benefits that could help Nissan improve the efficiency and effectiveness of its operations. Our calculations indicate that the supplier non-price benefits contribution decreased somewhat in 2014 (Row-5). The net economic gain Nissan expected in 2014 from aggressively pursuing price reductions from suppliers turned out be lower, not higher (Row-6)." (NOTE: Nissan's 2015 Annual Report was not yet available when this analyses was conducted, hence supplier profit contributions for 2015 could not be determined.)

		Nissan[2]			General Motors[2]		
Row	**Fiscal Year[1]**	**2013**	**2014**	**2015**	**2013**	**2014**	**2015**
R-1	Pressure to reduce price[3]	4.05	4.24	4.36	3.96	4.25	4.14
R-2	OEM threat of lose business / Fear of OEM retaliation reason for price concession[4]	17%	29%	33%	18%	27%	23%
R-3	Working Relations Index®	273	244	225	244	224	250
R-4	Supplier piece price concession contribution per vehicle[5]	$214	$146	?	$195	$194	$207
R-5	Supplier non-price benefits contribution per vehicle[5]	$2685	$2615	?	$2607	$2044	$2841
R-6	Supplier total contribution (R-4 + R-5) to OEM operating profit (EBIT) per vehicle[5]	$2899	$2761	?	$2802	$2237	$3048

[1] The Annual Study results relate to the OEM's fiscal year which is one year prior to the Annual Study year;, e.g., 2016 Annual Study results pertain to the OEMs' FY2015
[2] Red numbers indicate significant difference with the previous year; yellow box indicates significant difference with 2013
[3] Scale: 1 – To a little or no extent; 2 – To a little extent; 3 – To some extent; 4 – To a great extent; 5 – To a very great extent
[4] Percent of buying situations
[5] Supplier Profit Contributions per vehicle are based on light vehicles manufactured and wholesaled in North America; operating profit (EBIT) excludes any extra-ordinary expenses that may have been included in the OEM's annual report.

The same thing happened to General Motors. In 2014 GM pursued supplier price reductions more aggressively, relative to 2013 (Row-1). While GM suppliers didn't reduce their piece price contribution per vehicle in 2014 (Row-4), the suppliers' non-price benefits contribution dropped substantially (Row-5). The net economic result for GM in 2014 had the same impact as Nissan experienced in 2014. Suppliers' total contribution to both OEM's 2014 operating profit (EBIT) dropped relative to 2013 (Row-6).

In 2015 GM significantly reduced its price reduction pressure on suppliers (Row-1). While the pressure remained high, the percent of buying situations indicating that GM threated to reduce business or retaliate in some way also dropped (Row-2), while GM's WRI® improved significantly (Row-3). This suggests that in 2015, pressure was being applied on suppliers in a less aggressive, more collaborative manner than occurred in 2014, said Henke.

The net economic result for GM in 2015 was an increase in price concession contribution, non-price benefits contribution, and, subsequently, total contribution to operating profit (EBIT) from suppliers relative to 2013 and 2014 (Rows-4, 5, and 6).

"These positive results track our research which has conclusively proved that the more collaborative are supplier relations, the more suppliers will contribute to their customers' profits," said Henke. "With the significant demands facing the auto industry, no OEM can afford to marginalize its supplier relations. Every OEM must begin working today to ensure it will have significantly improved collaborative relations in the next several years."

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About The Study: Now in its 16th year, the Annual North American Automotive OEM-Tier 1 Supplier Working Relations Index® Study tracks supplier perceptions of working relations with their automaker customers in which they rate the US and Japanese automakers across the six major purchasing areas broken down into 14 commodity areas. The results of the study are used to calculate the WRI® which is then used to calculate the economic value of wo rk relations based on a proprietary PPI-developed economic model. The annual WRI® Index study has been recognized as the benchmark of supplier working relations for the automotive industry and has been cited in numerous academic research articles including in the *Harvard Business Review* and several books. This year, 647 sales persons from 492 Tier 1 suppliers – representing 1998 buying situations (e.g., supplying brake systems to FCA, tires to Toyota, seats to GM) and 63% of the six OEMs' annual buy – responded to the survey. Demographically, the supplier-respondents represent 38 of the Top 50 NA suppliers and 59 of the Top 100 NA suppliers.

About PPI: Since 1990, PPI has specialized in developing and implementing supplier surveys for the automotive OEMs and Tier 1 suppliers, and companies in 17 other service and manufacturing industries worldwide, including the airframe, aircraft engine, computer, construction tool, electronics, energy, and food industries. In 2001, PPI initiated its syndicated annual North American Automotive OEM - Supplier Working Relations Index® Study of the Big Six US and Japanese automakers and in 2010 began tracking the US-based German automakers as well. In 2011, PPI added a financial-impact study that quantifies the supplier contribution to the OEMs' profits that is related to the OEMs 'supplier relations status.

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