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New Study Shows Automakers Could Increase Profits by Improving their Supplier Relations

Detroit, August 4, 2014 – Results of a new study released today show that the major automakers – in fact, most manufacturing companies – could significantly improve their profits simply by improving their supplier relations.

The results are determined by the development of a unique economic model that proves and predicts a direct cause-effect relationship between an automotive OEM's supplier relations and the OEM's profitability, or in other words, an automaker's return on supplier relations.

According to the study, Chrysler, for instance, which went through a decade of turbulent ownership changes from 2000-2012 that included the worst supplier relations ever in 2007-2008, would have booked on average \$2 billion more in annual operating profit and \$1052 more in profit per vehicle if, during those years, it had maintained the higher level of supplier relations it achieved in 2011-2012. This equates to a total of \$24 billion in unrealized income over the period.

Similarly, annual profit gains could also be realized by all the automakers by improving supplier relations. For instance, if each of the six automakers had scored only 10 percent higher on the 2014 Working Relations Index[®], each would have gained an additional \$58 to \$152 in profit per vehicle, or \$98 million to \$400 million in operating profit, which can be attributed to the increase in better relations (see table below, columns 'a' and 'c'), according to the study.

	2014 WRI^{®1} (Actual)	10% Higher WRI[®]	Estimated Operating Income Increase per Vehicle	2013 N.A. Manufactured and Wholesaled Vehicles²	Total Increase in Operating Income (a)*(b)	Estimated. Operating Income Percentage Increase³
			(a)	(b)	(c)	
GM	244	268	\$152	2,638,000	\$400,112,000	5.4%
Chrysler	245	270	\$151	2,040,000	\$307,720,000	10.6%
Ford	267	294	\$130	2,526,000	\$327,354,000	3.7%
Nissan	273	300	\$123	792,000	\$ 97,260,000	6.1%
Honda	295	325	\$ 94	1,591,000	\$149,963,000	7.6%
Toyota	318	350	\$ 58	1,697,000	\$ 98,904,000	4.2%

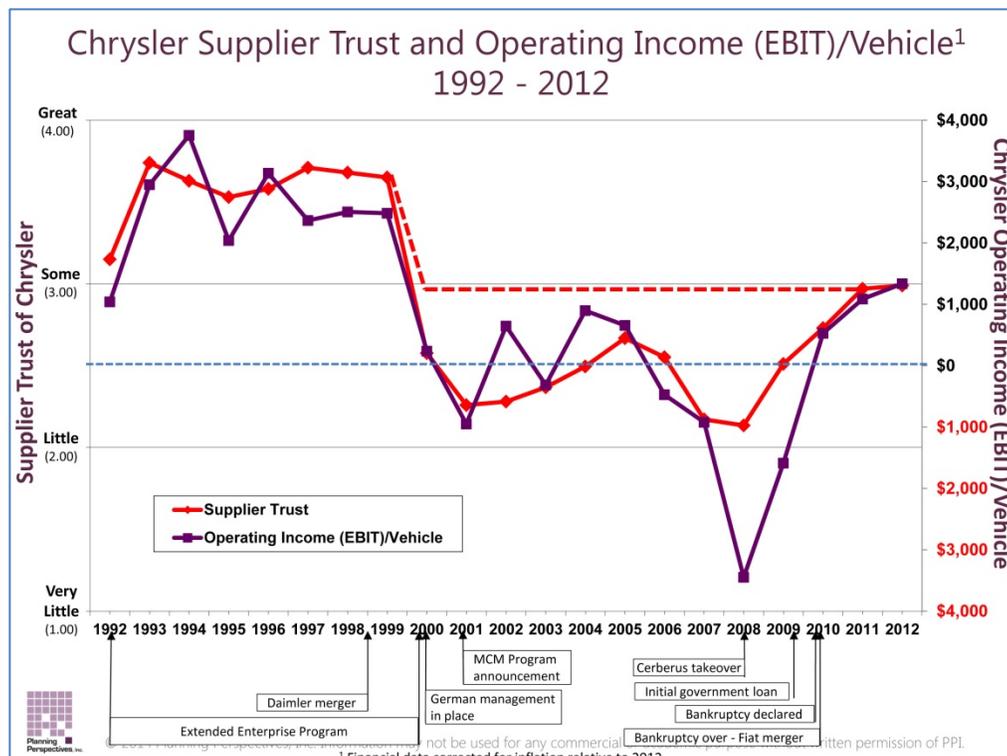
¹ WRI[®] from Planning Perspectives' Annual N.A. Automotive OEM-Tier 1 Supplier Working Relations Index[®] Study reflects relations in the previous year; ² Ward's Automotive Group, Southfield, MI; ³ Estimated percent increase based on operating income data obtained from 2013 OEM 10-K filings for Chrysler, Ford, and General Motors; and 2012 filings for Honda, Nissan and Toyota as fiscal 2013 data was not available when calculated.

The study's author is John W. Henke, Jr., Ph.D., president and CEO of Planning Perspectives, Inc., Birmingham, MI, (www.ppi1.com), and Professor of Marketing at Oakland University, Rochester, MI. For the past 25 years, Henke has specialized in studying and reporting on OEM buyer and supplier relations in the automotive and 17 other industries.

For the past 14 years, he has published an annual ranking of the six major North American automakers called the Working Relations Index[®] that ranks the relations the Detroit 3 and Japanese 3 automakers each have with their suppliers. The German automakers were added to the Annual Study in 2012.

The new study titled *OEM Profitability and Supplier Relations* by Henke and his co-researcher, Professor Sengun Yenyurt at Rutgers University Business School, New Brunswick, NJ, is based in part on data gathered over the past 13 years from Henke's annual Working Relations Index[®] Study, and breaks new ground in supplier relations and business performance analysis.

“While Chrysler is a dramatic example because of its history of extreme volatility in supplier relations under various owners during the past 20 years, all of the major automakers could be making hundreds of millions dollars more annually if they focused more on improving their supplier relations,” said Henke.



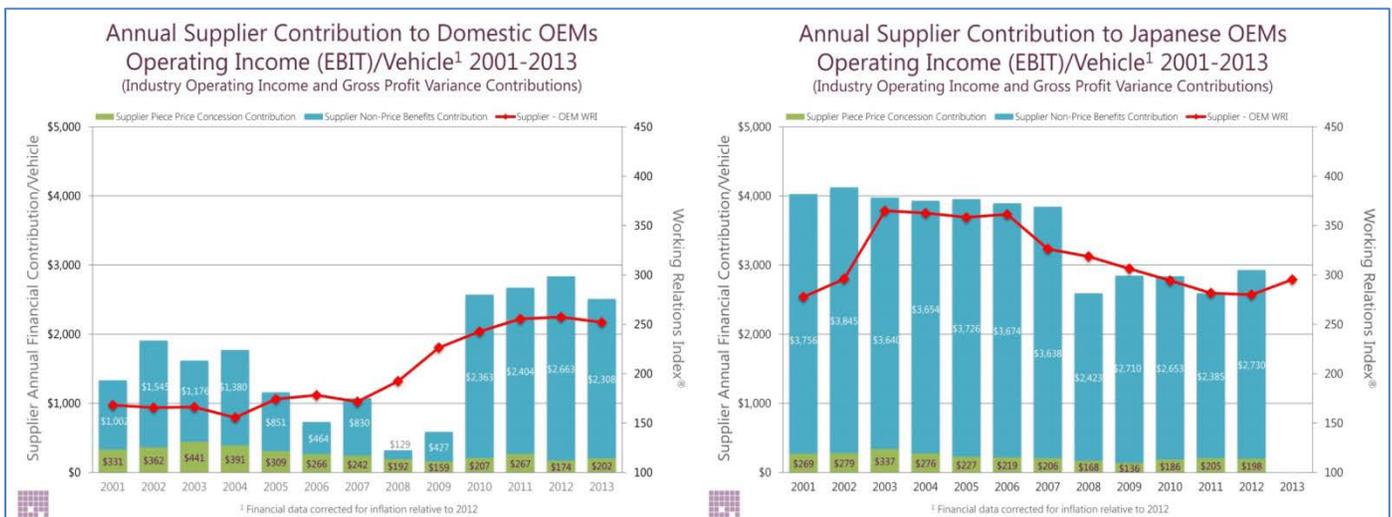
The horizontal broken line from 2000-2011 indicates the period that cost Chrysler \$2 billion annually in operating profit or \$1052 profit per vehicle. Over the 12 years, this “loss” totals \$24 billion, graphically illustrating the impact of poor supplier relations on OEM profits. Note how Supplier Trust (red line) tracks Operating Income.

“For years, academics and management consultants have suggested companies focused on developing positive relations with their suppliers and other major stakeholders will perform better financially. Many CEOs and purchasing executives intuitively agree with them,” said Henke.

“Consultants have tended to support their conclusions with anecdotal information, while academics have used rigorous statistical methods to support the many benefits they have identified that result from good supplier relations. However, no one has been able to show, let alone prove, a cause-effect relationship between supplier relations and customer profits. We have now done it.”

The study is important because, for the first time, it reveals three critically important characteristics of supplier relations, said Henke:

1. It proves a causal relationship between supplier relations and OEM profit. The better the relations with suppliers, the greater the supplier contribution to the OEM's profit; the more adversarial the relations, the less the contribution to OEM profit.
2. It quantifies the economic value of suppliers' non-price benefits to the OEM for such things as supplier sharing new technology, providing “A - team” support to the OEM, providing support that goes beyond the supplier's contractual obligation, and other “soft” benefits.
3. It establishes the fact that the economic value of the suppliers' non-price benefits can greatly exceed the economic benefit realized from suppliers' price concessions. On average, this can be up to 4-5 times greater, and often much more (see bar charts below).



These two graphs compare the US automakers (left) to the Japanese automakers (right) in return on supplier relations. Note how the vertical supplier contribution bars follow the red horizontal Working Relations Index line; the better the relations, the greater the supplier contribution (right); the more adversarial the relations, the smaller the contribution (left). Note in both cases the supplier price contribution (green bar) is only a fraction of the supplier non-price benefits contribution (blue bar). Finally, note how much greater is the total supplier contribution on average the Japanese automakers realize (right graph) than do the US automakers.

“If the automakers – especially the US automakers – really want to improve their profitability over the long term, they need to re-prioritize their efforts,” said Henke. “While adversarial tactics, such as beating up suppliers for lower prices, work in the short-term, they don’t offer nearly the benefit in the long-term that improving supplier relations does.

“Our study shows that if the OEMs focused their energy on improving their working relations with their suppliers – working with them as trusted partners for the long haul – the OEMs would realize much greater profit improvement than any adversarial efforts may generate. Toyota and Honda are proof of this.”

Henke’s annual Working Relations Index® Study has shown conclusively that automakers which rank highest on the Working Relations Index® not only get greater direct economic benefit from their suppliers in the form of greater price concessions but they also realize greater non-price benefits.

Supplier non-price benefits include such things as advanced technology, more supplier resources committed to their businesses, and higher quality parts and components. These can make a significant contribution to reducing OEM operating costs -- including lower warranty and recall costs – and increased profit per vehicle. However, until now, the economic contribution of these “soft” non-price benefits was unknown.

**Typical Supplier
Non-Price Benefits
Contributed to OEM
Customers**

- Quicker time to market
- Greater supplier investment in OEM business
- More open two-way communication to head-off problems earlier
- Greater new technology sharing, earlier
- Improved quality
- Improved delivery performance

Unique study

The *OEM Profitability and Supplier Relations* study is unique. Academia, consultants and OEM managers have long been able to quantify the impact on profits of such things labor costs and supplier price concessions. But no one has even been able to quantify the suppliers’ non-price contribution. The new study shows that OEM profitability results from three sources:

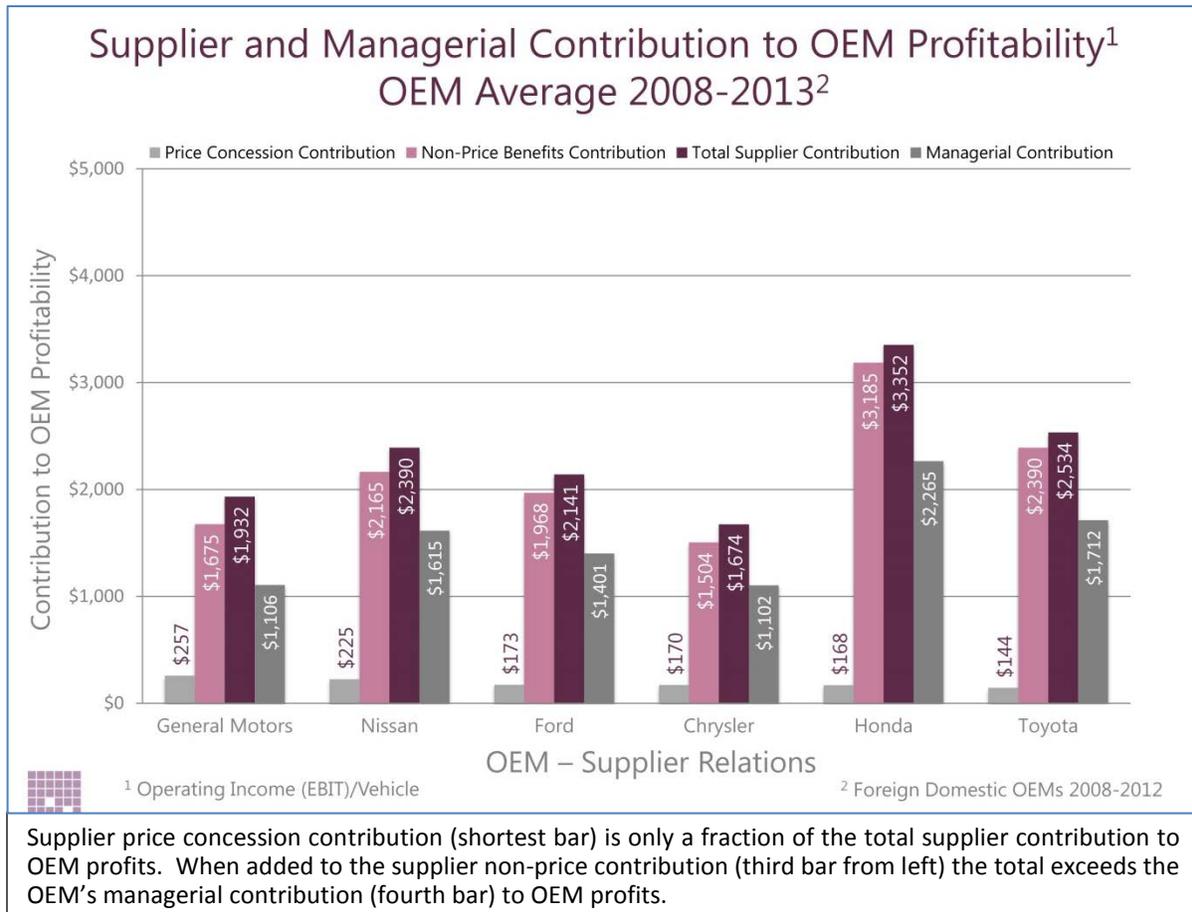
- The OEM’s internal managerial capabilities, which includes such things as skills, productivity, sales incentives, manufacturing efficiency, etc.
- Suppliers’ pricing and price concessions.
- Suppliers’ non-price benefits such as new technology, customer support and other “soft” benefits. These non-price benefits contribute to the OEM customer’s efficiency and effectiveness, and thereby help reduce the OEM’s costs of operation.

The Challenge: Calculating the Value of Non-Price Benefits

Determining the economic value of suppliers' profit contribution to an automaker was a challenge. While each automaker's annual financial and production data are publicly available in several forms (annual reports, 10-K filings, media reports and others), the study required all the OEMs' financial measures to be standardized for domestically manufactured and sold light-duty vehicles for each of the six major automakers across each of the 14 years of the study, which ranged from 2001-2013.

Next, a model was created relating the OEM supplier relations to the OEMs' gross profits per vehicle, and another to the OEM's operating profits (EBIT) per vehicle. Then the economic value of price concessions suppliers provide the OEM had to be determined for each OEM. This was relatively easy because price concession data is among the proprietary information PPI has gathered from suppliers since 2001 in its annual Working Relations Index® Study.

Finally, the most elusive value – the supplier non-price benefits contribution to OEM profitability – had to be determined. This was the most difficult problem to solve because there is no way to directly measure the economic contribution of each of the various non-price benefits.



However, because both the supplier price concession and the total supplier contribution *can* be calculated, it essentially becomes an algebraic equation that solves for “X” – the supplier non-price benefit contribution. With this value, all three annual supplier contribution figures can be determined for each OEM.

Conclusion

“Our study proves that the most significant economic impact a supplier has on its OEM customers’ profits comes from the non-price related benefits the supplier brings to the automaker,” said Henke.

“In fact, our calculations show that across the six major automakers, on average, 51 percent of the automakers’ profit per vehicle can be accounted for by the relations the OEM has with its suppliers. That contribution is comprised of supplier price concessions which are as little as 5 percent of the total supplier profit contribution when relations are particularly good (see graph above, *Supplier and Managerial Contribution to OEM Profitability*).

“The results clearly show that the OEM interested in improving its profitability should definitely look to its suppliers, not to squeeze them for lower prices, but to work toward achieving better relations with them, and by working to develop and then maintain sustainable long-term positive relations with them.”

It is important to realize, said Henke, that while the *OEM Profitability and Supplier Relations Study* focused on the auto industry, the results clearly apply to companies in every manufacturing industry.

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About the OEM Profitability & Supplier Relations Study: This new study takes the annual WRI Study a step further and quantifies the economic impact of supplier relations on OEM profitability. This groundbreaking study proves a cause-effect relationship between supplier relations and OEM profitability; quantifies the value of supplier non-price benefits; and proves suppliers’ non-price benefits to the OEM greatly exceed the value of price concessions.

About the annual WRI[®] Study: Now in its 14th 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[®] based on five key areas that contribute to collaborative supplier relations; these areas, in turn, are further broken down into 16 working relations variables.

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 Big 3 German automakers as well. PPI is based in Birmingham, Michigan USA and can be reached at +1.248.644.7690. Visit PPI at www.ppi1.com.