Auto suppliers: Sub-tier stress is building while sustainability is trying to get traction

Deloitte Commentary: Q2 2023 MEMA OE Automotive Supplier Barometer

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The MEMA OE Q2 2023 Automotive Supplier Barometer[1] (the "Barometer") results continue to highlight a significant amount of concern across the auto supply sector. Survey respondents point to potential weakness in the U.S. economy, in addition to material costs and shortages, as the greatest threat to the industry over the next 12 months. However, the current environment may also yield significant opportunities for well-positioned suppliers to consolidate customer relationships, competitors, and conquest business. To put this in perspective, the battery electric vehicle (BEV) segment ranks a distant second to conquest and consolidation efforts as the biggest opportunities for suppliers right now.

Overall, 44% of survey respondents remain pessimistic about the prospects for their business over the coming 12 months (vs. 36% last quarter) despite a slight easing of supply chain pressures and vehicle production levels that continue to normalize. In fact, North American light vehicle production is expected to reach 14.3 million units this year, on its way back to 16.5 million units by the middle of the decade as dealer inventories are replenished and pent-up consumer demand is released into the market.[2] The return to a relatively stable market and production forecast should be welcome news for suppliers that have struggled with production cuts and rising costs as the semi-conductor crisis and other factors impacted the business.

However, a stagnant forecast over the second half of the decade[3] is more worrisome for suppliers trying to keep up with a long list of customer requirements, including cost efficiencies, directed buy arrangements, the shift to electric vehicles (EVs), and ESG compliance.

As the Barometer results point out, 43% of suppliers indicated the primary motivation for initiating a sustainability program was a request from a customer, outpacing internal decision-making as the prime reason to move in that direction. However, even though vehicle manufacturers are mandating suppliers make these investments, more than half of survey respondents (58%) are reporting that it has not led to any additional business via access to new customer programs. Only eight percent of suppliers reported that adhering to ESG requirements had a moderate or significant impact on their ability to close new business. Having said that, the potential penalty for non-compliance could amount to an original equipment manufacturer (OEM) deciding to sideline the supplier in favor of other more amenable partners.

Barometer results also suggest there are two main obstacles preventing suppliers from implementing ESG initiatives: a lack of resources required to execute the strategy, and multiple conflicting customer requirements. Even so, the “carrot and stick” approach emanating from the vehicle manufacturers may be helping publicly traded suppliers establish carbon neutrality goals and prepare for proposed climate-related SEC disclosure rules.

Suppliers also face increasing pressure to align with their customers’ efforts to re-shore their manufacturing footprint. However, supplier executives cite key challenges such as finding qualified Tier N suppliers at the price points expected by their manufacturer customers. Suppliers also point to the overall issue of labor availability in the U.S. as one of the top threats to their business. Replacing a large cohort of aging workers with the next generation of the workforce may be a significant hurdle for many businesses. To get around this issue, some OEMs and suppliers are continuing to focus on Mexico as an attractive manufacturing destination that still offers relatively plentiful labor at reasonable rates. As a result, Mexico is expected to raise its share of North American light vehicle production from 23% this year to an estimated 26% by the end of the decade, potentially at the expense of Canada which is expected to drop two percentage points of market share over the same time period.[4]

In order to navigate sector risks and challenges, findings from Deloitte’s 2023 Automotive Supplier Study suggest suppliers can focus on four critical tasks: streamlining operating costs and protecting margins, critically evaluating material sourcing strategies, focusing on where to play, and looking for M&A opportunities. The first two tasks require suppliers to look inward and examine their organization from top to bottom. The second pair of opportunities require companies to consider the market around them and decide how they can best engage with it.

As suppliers pivot from one challenge to another, they should balance their focus on addressing near-term threats with a longer-term view to aligning their business for success down the road. Companies should also keep an eye out for opportunities to gain market share and solidify customer relationships as sector growth begins to flatten off. In a world where suppliers have been tested time and time again for three years straight, it’s quite remarkable that we haven’t seen more disruption in the space. However, as any seasoned supplier executive knows, past resilience doesn’t guarantee future success and the sector likely isn’t out of the woods yet with the worry that volatility is the new normal.

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Endnotes

[1] 2023 Q2 MEMA Automotive Supplier Barometer, MEMA Original Equipment Suppliers, June 2023.
[2] S&P Global Mobility Light Vehicle Production Forecast.
[3] ibid.
[4] ibid.

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