



Suppliers bracing for impact of labor negotiations and the need for capital to fuel growth

Deloitte Commentary: Q3 2023 MEMA OE Automotive Supplier Barometer

Jason Coffman and Ryan Robinson

When you have weathered crisis after crisis for the past three years, from a wholesale shift in powertrain technology to production shutdowns and semiconductor shortages leading to a vehicle inventory crash, why not add one more to the pile? That's how some automotive suppliers must be feeling as a new threat of labor disruption looms large on the horizon.

In fact, the latest results from the MEMA OE Q3 2023 Automotive Supplier Barometer (the "Barometer") indicate that 'labor availability constraints' have overtaken concerns about potential weakness in the U.S. economy as the greatest threat to their business over the next 12 months.¹ Other concerns include the 'likelihood of higher interest rates' and 'poor sales of

vehicles in programs supplied' reflecting the surprisingly rapid return of large dealer inventories, and significant incentives in the market.²

Although concerns over the economy are being overshadowed by the pending labor talks, 4 in 10 suppliers responding to the Barometer survey still peg the probability of a recession in the next year at 60% or higher. Perhaps more concerning is the fact that only 60% of suppliers report feeling at least somewhat prepared for an economic downturn. Steps taken by these suppliers to prepare include contingency planning with a focus on flexible labor, and a host of cost/margin management measures.

Another area of focus for some suppliers is the need for capital to drive a variety of strategic initiatives. In the last 12 months, 21% of suppliers report significantly altering their capital structure (up from 15% last year) with nearly half tapping bank loans as a new source of funding.³ Strategic initiatives requiring significant capital in the coming year range from new tooling and facilities to product innovation and M&A opportunities. This aligns with the key findings from Deloitte's [2023 Automotive Supplier Study](#) where companies can leverage an M&A strategy to acquire customers, talent and/or technologies to either expand or defend their market position. Suppliers looking to pivot their business can also divest non-core assets to either strategic or financial buyers to allow for a more radical reallocation of capital to support growth. Further, Barometer results suggest 6 in 10 suppliers are at least somewhat confident they will be able to access the capital required to support their M&A ambitions.

Over half of suppliers (57%) are very confident of implementing the capital investment needed to meet their near-term demand requirements for the remainder of this year. However, that percentage drops to 44% next year and 38% in 2025 as the uncertainty of market conditions including unplanned production shutdowns cloud the forecast horizon.⁴ Also standing in the way is the rising cost of capital that accompanied the rapid increase in inflation which sparked an aggressive series of interest rate hikes by the Federal Reserve.⁵ This is hitting suppliers at a particularly vulnerable time as many are carrying a significant amount of debt.⁶ The need to manage cash and operating capital is important, particularly for those suppliers that may be caught out by production disruptions caused by a potential strike action, leaving them with excess inventory for an undetermined period of time.

Some suppliers may be looking to access capital to fuel growth in North American manufacturing

capacity. In particular, Mexico stands to gain in terms of attracting capex investment over the next 5 years as 42% of suppliers believe capital investments in that market will outstrip its share of corporate sales over that timeframe.⁷ This is reflected in the fact that Mexico is actively trying to attract both manufacturing and engineering services investments as some OEMs continue rethink their global EV production footprints and associated supply chains in the wake of severe disruptions experienced over the past three years.⁸

Despite the challenging environment, a majority of suppliers (80%) are confident they will be able to access the capital required to fund product innovation programs.⁹ Many companies will likely need it as 45% of respondents to the MEMA survey feel they are behind their peer group in terms of the rate at which they are able to innovate. Only 18% of suppliers feel they are leading the way on innovation with the remaining group merely pulling even with their peers.

When it comes to driving innovation, the need to keep pace with the generational shift to electric vehicles appears ever-present. Some suppliers have responded by constructing capital strategies that are highly supportive of working with external partners to shore up technology gaps and accelerate R&D programs.¹⁰ To put this need into perspective, the market for electric drivetrain and battery components is expected to grow from US\$58 billion in 2022 to US\$200 billion by 2027.¹¹

Suppliers should choose the right partners and customers as competitive pressures will likely continue to build in a highly volatile climate. While it may be impossible for suppliers to fully “future proof” themselves against all possible scenarios, focusing on the right strategic growth initiatives could help them not only weather the next storm, but thrive in a rapidly evolving industry.

Contact

Jason Coffman
Principal
Deloitte Consulting LLP
jasoncoffman@deloitte.com

Endnotes

¹ 2023 Q3 MEMA Automotive Supplier Barometer, MEMA Original Equipment Suppliers, August 2023.

² [“New-vehicle inventory hits two-year high in May, average listing price dips”](#), Cox Automotive, June 15, 2023.

³ 2023 Q3 MEMA Automotive Supplier Barometer, MEMA Original Equipment Suppliers, August 2023.

⁴ Ibid.

⁵ Jason Coffman, Raj Iyer and Ryan Robinson, [2023 Automotive Supplier Study](#), Deloitte, April 2023.

⁶ John Irwin, [“Auto suppliers are asking for contract relief”](#), Automotive News, August 14, 2022.

⁷ 2023 Q3 MEMA Automotive Supplier Barometer, MEMA Original Equipment Suppliers, August 2023.

⁸ Carolina Gonzales and Crayton Harrison, [“Mexico is trying to lure the world’s biggest car makers to a strip of land in south”](#), BNN Bloomberg, June 1, 2023.

⁹ 2023 Q3 MEMA Automotive Supplier Barometer, MEMA Original Equipment Suppliers, August 2023.

¹⁰ Jason Coffman, Raj Iyer and Ryan Robinson, [2023 Automotive Supplier Study](#), Deloitte, April 2023.

¹¹ Ibid.

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