



Creating a Win-Win for Auto Manufacturers and Suppliers:

A Strategic Approach to Commercial Margin Recovery

This is the first article in our series on how to build a fair and equitable cost-recovery relationship between auto manufacturers and their suppliers

Introduction

The European automotive industry is facing a tough and competitive landscape. Rising geopolitical tensions, weak growth, a market decline in developed countries and supply chain disruptions are dragging on the sector, while new entrants and advances in electric vehicle (EV) technology are challenging the status quo.

These trends are causing a significant strain on the relationship between original equipment manufacturers (OEMs) and suppliers, increasing conflicts of interest, pressuring margins and impacting conventional business models in the automotive sector. Professional cost recovery management and negotiations hold the key to optimizing this “pain share.”

In this article, we will explore the common misunderstandings of the “other party,” that lead to avoidable conflicts and illustrate with a case study how best outcomes can be achieved for both OEMs and suppliers in margin recovery negotiations. In future articles in this series, we will dive into the nuances of the OEM’s perspective, the supplier’s perspective and how business models can be adapted for success in the longer term.

Background

A challenging economic and geopolitical backdrop is raising production costs and affecting overall profitability across the chain in the automotive industry, be it an OEM or a supplier.

Weak domestic demand is weighing on autos.¹ Sanctions and trade restrictions related to the ongoing conflict in Ukraine, elevated inflation and an increasing frequency of disruptive climate events are causing delays and shortages in essential inputs and affecting competitiveness.

Moreover, market volatility is also causing uncertainties in forecasts and strategic planning.

And while the EU’s green goals require all new vehicles to be zero emission by 2035, a recent report noted that the region’s auto industry is suffering from higher production costs, lagging technological capabilities, increasing supply-chain dependencies and declining brand value.²

These challenges have led to diverging concerns between suppliers and OEMs of late. While the supplier is looking to maximize the potential of commercial recoveries as input cost factors have risen substantially (sometimes to the point of threatening economic survival), the OEM is looking to minimize cost and de-risk their supplier portfolio.

Working with the other side

Both the supplier and the OEM invest significant time and effort in negotiating and enforcing claims. However, there is often information asymmetry, common misunderstandings or lack of an in-depth understanding of issues faced by the other party (particularly on the OEM side). This leads to inefficient processes, increased effort, additional costs and dissatisfaction at the outcome for both sides. It may also result in OEMs allocating value to suppliers less in need than others.

¹ “EU Car Sales at 3-Year Low in August, EV Sales Plunge 44%.” Reuters. September 19, 2024

² “EU Competitiveness: Looking Ahead.” European Commission. September 9, 2024.



A fair distribution of costs and compensations would be in the best interest of the entire industry, allocating capital where it can deliver the most value and leading to a more sustainable and resilient supply chain.

In our extensive experience in the automotive industry, the following issues commonly arise during negotiations:



What OEMs (often mistakenly) think:

1. **Exploitation of goal:**

"The supplier is focused on achieving internal financial goals without regard for broader context or OEM's situation"

2. **Lack of transparency:**

"The supplier is hiding the real costs or exaggerating the damage to demand higher compensation"

3. **Lack of risk awareness:**

"The supplier's claim isn't really urgent or essential to their survival"

4. **Blame-shifting:**

"The supplier is avoiding taking responsibility for their internal cost base, instead trying to boost profitability at the OEM's expense"



What suppliers (often mistakenly) think:

1. **Lack of awareness of OEM challenges:**

"OEMs aren't under cost or efficiency pressures themselves"

2. **Underestimating internal OEM complexity:**

"OEM decisions face no internal resistance or requirements to align with multiple levels of stakeholders"

3. **Misunderstood prioritization:**

"OEMs are intentionally delaying or ignoring claims, hoping the situation will go away on its own"

In addition to these misunderstandings, some diverging concerns between OEMs and suppliers also strain their relationship.

OEMs are struggling with profitability and therefore prioritizing efforts on their own cost management and efficiency programs, leaving them with less bandwidth to handle supplier issues.

Suppliers, meanwhile, are grappling with an increasing cost base, slow realization of claims, volatile series business and dwindling margins, which are raising their exposure to risk, worsening refinancing terms and at times even breaching debt covenants.

In the current business climate, both sides must prepare strategically for negotiations, paying attention to optimized pain-sharing and proactive stakeholder management.

A&M recently supported a Tier-1 automotive supplier and a key German OEM with their negotiations, with the outcome creating a win-win situation for both parties involved. Below we outline the essential considerations that led to successful results.



Recovery negotiations: A case study

The case involved a large, multibillion-euro automotive supplier, facing a severe cost deficit that threatened its financial stability and operational viability.

The supplier proposed a “general price increase claim” but could not provide a detailed breakdown or justification based on specific cost categories. There was a lack of benchmarks and cost indexes to support the claim and the supplier’s financial transparency was limited. Additionally, some projects were operating at a loss, resulting in margin erosion and raising concerns about the supplier’s sustainability and ability to secure necessary refinancing.

Together with the supplier, A&M undertook a structured approach to create a clearly defined preparation document to aid the supplier in its negotiations with the OEM. This included outlining the financial and operational challenges the supplier faced, via the six-step process below:



By facilitating discussions between the supplier and the OEM, conducting skilful negotiations and defining a clear sense of urgency and ask of the OEM, A&M was able to help both parties achieve a mutual understanding of the precariousness of the situation. A&M’s engagement in the negotiations resulted in the following positives for the parties involved:



Faster process: The two parties had negotiated for months without clear results before A&M entered the fray.



Stronger relationship: Supplier gained standing in the eyes of the OEM because of fair and professional dealings, easing the procurement function of the OEM.



Balanced pain share: Supplier secured willingness from the OEM to contribute to the pain share accordingly. The OEM also agreed that no business-on-hold was necessary.

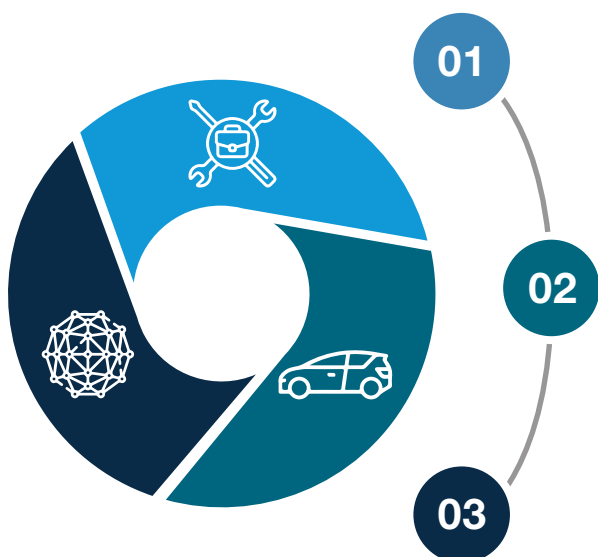


Fair amount: The mutually agreed upon amount was sufficient to make a difference to the supplier’s balance sheet, while leaving the OEM satisfied that the ask was genuine.



How A&M can help

We are hands-on experts with deep industry knowledge, gained through years of experience working directly with suppliers and OEMs. We know the real challenges and how to tackle them effectively to deliver tangible, mutually satisfactory outcomes for both parties. Our expertise includes deploying the right tactics for the negotiations by leveraging our extensive knowledge of negotiation methodologies, determining a clear escalation path (engaging appropriate stakeholders in the hierarchy at the appropriate time), identifying pressure points in the process and an understanding of both perspectives. A&M can bring beneficial outcomes for stakeholders across the automotive industry, from OEMs and suppliers to industry associations and policymakers.



Automotive supplier

- Proven science and arts approach
- Analytics toolbox to quantify and explain the claim base with in-depth analysis
- Identification of key OEM stakeholders for negotiations
- Coordinate Top-Level Escalation and Cross-Functional Alignment for consistent messaging

Automotive OEM

- Evaluation of fair pain share
- Methodology to create transparency on supplier portfolio and prioritization of resource allocation
- Professional and efficient execution through negotiations

Automotive industry associations and policymakers

- Offering of a fair compensation process that allows for efficient resource allocation
- Redefinition of the rules of the game: collaborative approach and creating win wins across all parties involved

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