Optimizing Commercial Margin Recovery in Volatile Times: Best Practices for Automotive Suppliers

This article is the second in our series on commercial margin recovery in the automotive industry and discusses the supplier's perspective.

For the first part of the series
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Introduction

The global automotive supplier industry is grappling with significant pressures, particularly on input factors. In such a volatile environment, suppliers can face drastic changes in circumstance after the contract has been signed, exerting margin pressure.

Commercial margin recovery is growing increasingly relevant for industries where long-term contracts are a key revenue stream, such as the auto industry, because of fluctuations in factors ranging from political decisions to sales volume and new competition.

But talks with original equipment manufacturers need not be acrimonious. In this article, we will show how suppliers can maximize their negotiating position, strengthen relationships with OEMs and achieve a mutually beneficial outcome by focusing on certain key considerations.

Margin Pressure Factors

Grounds for claims arise when a company's circumstances change significantly, often due to external factors, between the time of signing the contract and the agreed-upon delivery date. Below are the main factors exerting pressure on suppliers at present:

1 Volume/Demand volatility

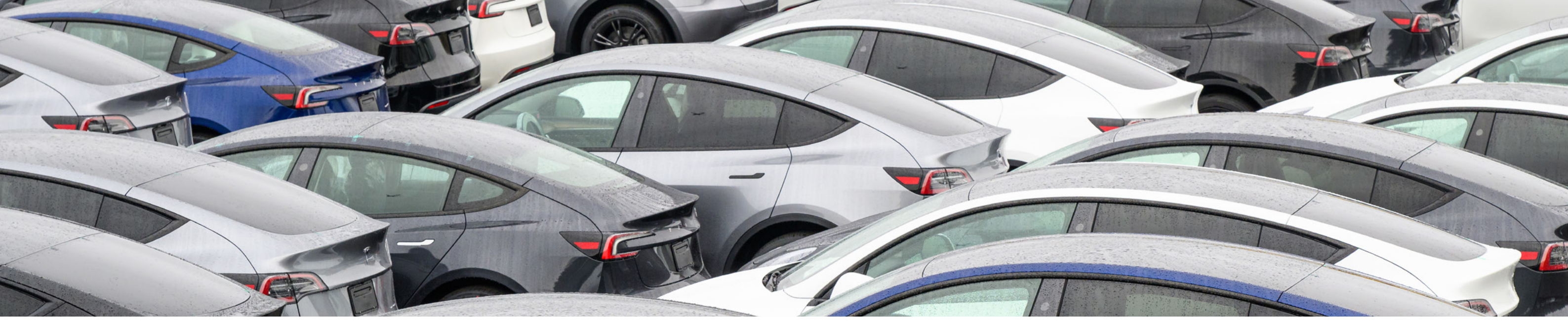
Fluctuating consumer demand from OEMs is resulting in lower order rates for suppliers. This leads to uncovered fixed costs, underutilized production capacities and non-recovered development costs.

Suppliers are also facing challenges from non-amortized investments and frequent project schedule changes, resulting in increased inefficiencies. At the same time, delays or shifts in the start of production (SOP) can create additional costs like increased working capital requirements and ramp-up expenses.

2 Hardship costs

Unexpected costs from loss-making or special projects can also put significant financial strain on suppliers, particularly when it comes to strategic projects with longer-term payoffs for OEMs. Suppliers must often absorb these short-term losses to secure long-term gains.

Additionally, OEMs may allocate budgets to manage increased costs in specific material groups, such as semiconductors. This includes strategies like spot buys, redesigns, requalification efforts, excess inventory management, directed buys, foreign exchange impacts and end-of-production (EOP) claims.



3 Project delays and cancellations

As the automotive industry makes inroads into next-generation technologies and platforms around electric vehicles and smart cars, delays and cancellations of ambitious projects will also add to margin pressure. Auto companies are investing billions of euros into developing next-gen architecture and software systems. If they do not come to fruition, these projects can face heavy sunk costs around research and development, capital expenditure and investments and supplier costs, to name a few. For suppliers, this means factoring in future opportunity costs, as delayed or cancelled projects may mean missing out on expected product margins, license fees for software and so on.

4 Tariffs

Another factor contributing to pressures is uncertainty around tariffs. Rising tensions between the U.S. and prominent trade partners at the beginning of the year put significant pressure on the global automotive industry, with tariffs and counter tariffs between the U.S. and China in particular turning up the heat. Since then, tensions have abated[1], although the evolving scenario highlights the need for suppliers and OEMs to be well-prepared and resilient when faced with reduced visibility on future costs.

Trade tensions raise the risk of disruption in production and a decline in sales, while higher input costs may impact profitability. While inflation has cooled in recent months, it has had a significant impact on costs across multiple areas for suppliers and OEMS in the past few years, including on material, energy, labor and logistics.

Gearing up for Success: Best Practices for Negotiations

As sales volumes decrease and input costs increase, claims management is becoming a significant area of focus. Suppliers must bear in mind the following key considerations to maximize their negotiating position with OEMs:

Optimized pain share

Suppliers must prepare cost items in a strategic and structured manner - for example, via a claims bridge - to establish an appropriate "pain share" between stakeholders so that cost risks are allocated fairly. The ultimate goal is to create a fair margin distribution along the supply chain. The preparatory process for the negotiations includes analytical preparation, comprehensive planning, and effective realization.

Stakeholder mapping

Besides a thorough preparation of the commercial strategy, suppliers must also pay attention to the stakeholders involved in the recovery negotiations as these usually expand beyond their regular procurement counterparts. This ensures that the claim is positioned at the right level of the organization with the relevant decision-making power.

Fair distribution in the automotive value chain

Suppliers can improve process efficiency by understanding the requirements of the OEM, ensuring the procurement function follows the OEM's internal processes to get the releases and preparing the analytics and claims document in a manner easily understood by the OEM. Taking these steps will help secure long-term functionality in the ecosystem.

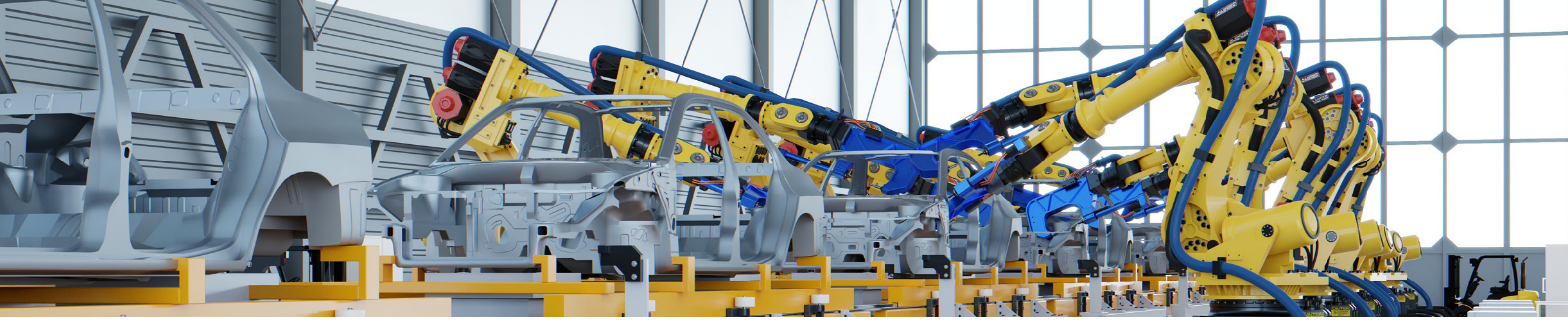
New normal of negotiations

Supplier often follow their known interaction behavior with OEMs and cannot anchor the new needs and stance required to get to results. External representatives such as A&M, with experience in numerous cases, can help suppliers benchmark their required tone and positioning befitting their new normal.

Other business relations

While there is a trade-off between strategic partnerships, new business tenders and so on, suppliers should take a strategic view of claims and stay focused on their ultimate targets, without mixing their analytics and arguments among other business factors.

1 https://www.spglobal.com/automotive-insights/en/rapid-impact-analysis/future-of-uk-china-tariffs-negotiations



How A&M can help: The arts and science approach

A&M has extensive experience in managing commercial margin recovery negotiations, with deep specific knowledge of major OEMs as well as suppliers in the automotive industry. We deliver impactful outcomes that professionalize claims management for suppliers and strengthen their relationship and trust with their OEMs.

Our proven approach stems from combining the science of analytical rigor with the art of negotiation best practices.

Science approach

Methodological rigor

- Validate rightful claim per claim category
- Systematic benchmarking of cost data with external sources and supplier peer group
- Clear analytical justification and arguments per claim position

360-degree negotiation preparation

- Cross-functional collection of relevant data regarding supplier
- Derive convincing negotiation arguments based on factual/analytical baseline, comparison with peer group, etc.

Arts approach

360-degree negotiation tactics

- Managing the escalation pyramid
- Leveraging cross-functional stakeholders to OEMs (such as production and logistics) to deliver decisive and consistent messages
- Develop plan in alignment with material group-specific strategy towards OEMs

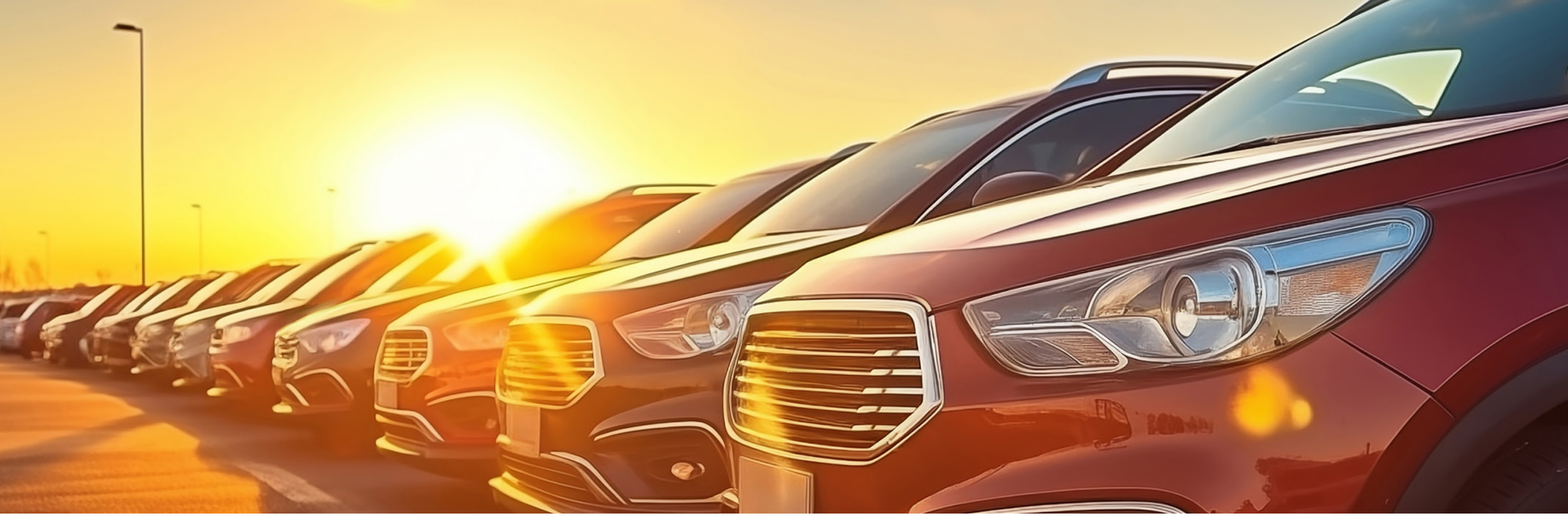
Rehearsals before key negotiation rounds

- Simulation of negotiation meeting with all negotiation participants to enhance preparedness

Professional closing of negotiations

- Clear commitments on both sides, clarity on relationship going forward, explicit agreement on implementation

At A&M, we calculate the claims scope and formulate arguments rigorously, while at the same time ensuring that all tactical discussions and the final escalations are framed within the context of the overall company strategy with the respective OEM. In the next section, we illustrate how our unique blended approach resulted in tangible results for our client.



Case study

The Situation

A billion-euro automotive supplier with a global footprint was running a negative EBIT and was close to breaching its financial covenant, which could have resulted in financing being withdrawn or the banks appointing external personnel.

A&M's Engagement

Our team deployed a combined arts and science approach to achieve a successful outcome for the client.

Science

- Assessed claim values across all categories
- Analyzed cost increases
- Validated cost development vs. indices
- Ensured transparent presentation of claim and financial situation

Art

- Established a cross-functional, cross-hierarchical task force mode
- Achieved internal alignment across departments
- Built a deep understanding of both sides and developed firm negotiation levers
- Enabled live tracking and simulation of negotiation outcomes
- Delivered financial analysis and communication for OEM risk management
- Assessed necessary operational measures based on negotiation results

Results

- A&M's engagement resulted in a 30 million-euro EBITDA impact (>3% of sales) through one-time compensation and revised pricing.
- Client achieved immediate liquidity relief through OEM cash support.

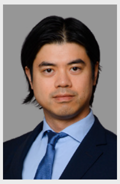
Conclusion

External factors exert significant pressure on automotive suppliers, with circumstances changing quickly between the signing of a contract and the delivery of goods. In this volatile environment, claims management is an important area of focus for suppliers grappling with higher input costs and prospects of delays and disruption.

By taking an approach that combines analytical rigor with optimal negotiating strategies, suppliers can ensure objectives are aligned and trust is maintained with the OEM to achieve a mutually beneficial outcome.

In the next instalment of our series on commercial margin recovery in the automotive industry, we discuss key considerations and actions from the OEM's perspective.

CONTACTS



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