AS GLOBAL CHALLENGES MOUNT, AUTO SUPPLIERS MUST REMAIN NIMBLE

Automotive suppliers are facing a host of challenges as they look ahead to 2020 and 2021. Whether it’s a global decline in the production of autos, simmering trade tensions around the world or the shift to electric vehicles, this ever-changing landscape is putting pressure on the vast global network of auto suppliers’ production, supply chain and financial metrics in a way that was hard to envision even months ago.

And it’s taking place amid perhaps one of the biggest potential health threats of all—the coronavirus outbreak in China. It is still unclear just how far-reaching the impact of this new virus will be, but with the death toll having surged past that of the 2003 SARS outbreak in China and with major manufacturing centers in China having been idled in the early weeks of the outbreak, the coronavirus has many manufacturers preparing for the worst.

If there is a common theme to these challenges, it is that auto suppliers must be nimble and be willing to change if they are to create long-term value.

Declining production

U.S. and global light-vehicle sales have fallen off since reaching a high in 2016 and 2017, and are on track to decline for the remainder of 2020 and into 2021. This is forcing suppliers to accelerate new model launches while optimizing their product mix, all in an effort to secure their pricing strategies to achieve overall revenue increases. Sedans, for example, have fallen from roughly half of all light-vehicle sales in the United States as recently as five years ago to less than a third today, prompting General Motors, Ford and Fiat Chrysler to focus instead on pickups and SUVs. As a result of production shifts, suppliers may be forced to consider other options such as teaming up with their competitors on product development and related research and development spend-sharing, considering strategic acquisitions, or restructuring their businesses to focus on their core competencies and strategic product development.

Key takeaway: Suppliers need to take a fresh, hard look at their core competencies and strategic product development.

Trade tensions

Along with declining global auto production, trade tensions are also putting pressure on the supply chain and are unlikely to subside in the near term. China is the world’s largest auto market and is critical to the long-term sustainability of the industry’s global supply chain. These tariffs are becoming a significant disruption in the supply chain, resulting in major operational challenges, increased manufacturing costs and a slowing in the production of product. Companies are going to have to evaluate where and how they produce their products and how they distribute them. Suppliers will have to better align themselves with the geographies of the customers they serve.

Key takeaway: Auto suppliers are already considering alternatives to diversifying and realigning their supply chain in an effort to mitigate China’s impact, including restructuring production facilities to realign with their customers. This realignment can require a significant investment, but the alternative means being vulnerable to tariffs and other shocks to the supply chain.

USMCA, the reality

One major part of this new trade landscape is the recently approved trade pact known as the United States-Mexico Canada Agreement. Touted as a way to bring auto industry jobs back to the United States, the USMCA will ultimately impose higher costs on American suppliers. Manufacturers will be left with a difficult choice: absorb the higher costs as lost margin, renegotiate parts supply deals as a way of lowering those costs, pass the costs on to consumers, or change their product mix to make offerings less expensive.

This choice is being driven by three major provisions of the USMCA:

• Content rules. NAFTA, the trade pact that preceded the USMCA, originally required automakers to use 62.5% of North American-made parts in their cars to be imported duty free; the new agreement gradually raises the bar to 75% by 2023, which will incentivize automakers to increase the amount of North American parts they use in their cars and light trucks.
• Labor. The USMCA requires automakers to manufacture 40% of their vehicles in facilities where assembly workers are earning a minimum of $16 an hour. While average wages for assembly workers in Canada and the United States are even higher than that, they are not in Mexico, where a number of U.S. automakers have shifted production in recent years to take advantage of the lower labor costs.
• Collective bargaining. Mexican government authorities are now required to allow workers to form collective bargaining units. This could lead to a more union-friendly regulatory environment.

Key takeaway: With costs of production rising in the United States, the new trade deal will only hasten the shift of sedan production to Mexico, at a time when those vehicles are already out of favor with consumers. Suppliers that serve this market segment will have to change their strategy to focus on light trucks and SUVs, as well as the growing battery electric vehicle (BEV) market segment.

Looking ahead

Today’s soft production environment will eventually recover to a trajectory of growth. And when it does, those suppliers that have realigned their production and product mix to accommodate a changed landscape in trade and shifting consumer tastes will be in position to reap the rewards.