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Auto Suppliers in Crisis: 2. Steps for Restructuring

by Jan Miecznikowski and Brian Collie

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Auto Suppliers in Crisis:
2. Steps for Restructuring

How to choose which units to cut and which to keep.

by Jan Miecznikowski and Brian Collie

The coming market structure correction in the automotive supply base will leave no company untouched. Auto sales are diminished, competition has increased, and financial constraints are greater; suppliers can no longer afford to subsidize weak businesses, especially those with little or no strategic value. It is now vitally important to free up resources and deploy them to those business units that have the potential to create sustainable, advantaged market positions. The most pressing challenge, of course, is deciding which businesses fit into this category.

An important, advantaged position is one that can be defended, and hence is sustainable. It's critical not to confuse this with the ability to earn a profit today in a particular niche. Especially in the radical restructuring that suppliers are now facing, companies must continually challenge themselves to define what a competitor might be able to do differently to attack their position and put their profit stream at risk.

There are two critical dimensions by which a business unit should be evaluated. The first is the financial performance of the unit; here, return on invested capital is the key metric. The second is the strategic importance of the business unit to the overall enterprise. Units that score high in both areas should be nurtured financially and allowed to expand, and units that score low in both areas should be sold at fair value. Given their performance, however, selling might be difficult, and in those cases suppliers are better off cutting back investments in lagging operations and running them out for the cash they generate. On the other hand, units that show above-par financial performance but are not a strategic fit with the broader enterprise will likely attract a fair value; they should be divested.

It gets a little trickier when a business unit provides strong financial returns and is complementary with, but not perfectly aligned with, the core mission of the company. These operations can be appraised by asking three questions: Does the current owner value this business unit more than another company would value it? Are the capabilities required to sustain it consistent with the broader enterprise? Would the current owner be willing to make a continuing and perhaps significant investment in this operation? If the answer to any of these questions is no, the unit should be sold.

Finally, units that are of core strategic importance but that have historically underperformed can present both a great challenge and a major opportunity. If fixed, these businesses offer the potential to provide tremendous improvement in the organization's overall financial performance and strategic position. But untouched, they will continue to drain resources, preventing the supplier from realizing its full potential and possibly risking its existence. These questions can help determine which units should be retained: Can a future be envisioned in which the business has gained a sustainable advantaged position? In other words, does the supplier have the skills, knowledge, and resources to first understand specific market needs and to then address them in a superior, differentiated way relative to the competition?

Over the long haul, automakers are keen to pay for just four things from suppliers: demonstrable reductions in original equipment costs through, for instance, lower logistics costs or lower system engineering costs; greater fuel economy; designs that promise widespread consumer interest; and a solution to intractable program issues, such as managing changes late in the development process. If an underperforming business unit already has a sustainable advantaged position or can achieve one, double down and invest in fixing it. If a business unit meets neither criterion, plan to run it out for cash. Only by conducting a market-back assessment, beginning with a systematic analysis of customers and their needs, and then considering whether the business unit has the capabilities and real potential to succeed in that market, can a supplier make confident decisions about strategic direction.

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This article is adapted from Miecznikowski and Collie's "Smart Bets for Auto Suppliers: Transforming Underperformers into Advantaged Players," Booz & Company white paper, August 2009.

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