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FEATURE

Caution ahead

Transformation and disruption for automotive suppliers

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INSIGHTS FROM DELOITTE'S 2019 GLOBAL AUTOMOTIVE SUPPLIER STUDY

Disruptive trends are changing the global automotive supplier landscape. To thrive and remain in business, suppliers need to shift gears and decide on which part of their business they want to expand, defend, and pivot.

FOR AUTOMAKERS, ORIGINAL equipment manufacturers (OEMs), and suppliers alike, the last decade has been fraught with uncertainty. Whether fighting for survival during the Great Recession or experimenting with new pathways to value creation in response to new mobility solutions and new competitors, executives have had to rethink almost every aspect of their business to stay ahead of the competition and continue to deliver innovative products and solutions.

Our first *Global Automotive Supplier Study*,[1] published in 2013, explored winning themes and strategic levers suppliers could pull to achieve superior returns. As the transformation and disruption of the automotive industry gained momentum, our subsequent supplier studies explored segment attractiveness and potential strategies for players operating in those segments. However, the massive shifts in the industry necessitate new strategic thinking to succeed. In this latest *Global Automotive Supplier Study*—our fourth—we delve further into the segment analysis first introduced in the third study.[2] We then present the most advantageous segments positioned for growth and outline three strategic moves suppliers can consider whether they operate in growing, stagnant, or declining product segments. We further outline implications for automotive supplier executives whose organizations fit into one of these categories.

Disruptive trends impacting automotive suppliers worldwide

Autonomous, electrified, and shared vehicles will likely change the face of mobility sooner than later, and *disruptive trends*—driven by advancements in technology, new entrants reshaping the automotive value chain, and changing consumer preferences—are bringing in that phase faster than many executives would think. We categorize these trends into four themes—electrification, shared mobility, technology convergence, and new entrants (figure 1).

Automotive suppliers have created US$510 billion[3] in shareholder value since the last recession, more than doubling the overall market value from the end of 2008. However, the top one-third of performers have accounted for more than 99 percent of that total value created.[4] We believe that after the impending recession,[5] continued success will depend on differentiated strategies across product portfolios and players will not be able to rely on the overall industry recovery to lift all stakeholders.

FIGURE 1

Four key transformative forces have a significant impact on the auto industry

Electrification

Increased regulatory pressure, technological improvements, investments in charging infrastructure, and environment-friendly customers drive the growth of e-powered vehicles.

Shared mobility

Preferences of younger, more urban customers to use ride-hailing services, along with saturation of smartphones and advanced 5G networks, will likely make shared mobility even more accessible and prolific.

New entrants

Big technology and consumer electronics players are entering the automotive value chain. They have challenged existing business models and placed pressure on traditional suppliers to innovate quickly and avoid getting left behind by faster-moving peers and rivals.

Technology convergence

Shifts in vehicle technology and functionality, such as proliferation of software and advances in autonomous driving, have led to a convergence of automotives and technology, and have transferred significant supplier value from hardware to software.

Recent market growth has led to a rapid increase in shareholder value. However, as the mobility transformation takes shape and new competitors claim market share, suppliers will find that past performance does not guarantee future value creation, especially now.

Source: Deloitte analysis.

While each of these themes has already started impacting the industry, it is their convergence that we believe will reshape the automotive value chain. In combination with looming macroeconomic headwinds,[6] these could cause a dramatic shift in the way automotive suppliers across the value chain compete. Based on where they play today, some automotive suppliers will need to develop and deploy entirely new strategies to respond and be best positioned to enable future success and replicate another trillion in value creation in the traditional supplier market over the following decade.

As a result of converging forces and macroeconomic headwinds, some automotive supply segments will face commoditization and decline, while others will experience significant growth.

TAKING A DEEPER DIVE INTO FOUR CONVERGING FORCES RESHAPING MOBILITY

Electrification

By 2025, there will be an estimated 25 to 30 million light passenger vehicles on the road worldwide equipped with some sort of electrified powertrain.[7] Our analysis reveals that compounded annual growth rates in fuel cells, battery electric vehicles (BEVs), plug-in hybrid electric vehicles (PHEVs), and other hybrid technologies could grow, on average, around 34 percent between now and 2025. At the same time, traditional internal combustion engines (ICE) and ICE powertrains equipped with start-stop technology will decline.

Consumers appear to be increasingly interested in electrified powertrains. Results of our *2019 Global Automotive Consumer Study*,[8]

which surveyed approximately 25,000 people in 20 countries, reveal that 65 percent of consumers in China are interested in an electrified powertrain in their next vehicle (up from 61 percent in 2018). In Japan, it is 59 percent, up from 48 percent in 2018. Study results even reveal an increase in consumer appeal in the United States, where 29 percent of consumers indicated they would prefer an electrified powertrain in their next vehicle, a 9 percentage point increase from 2018.

In response to electrification trends, we have seen industry players refocus their portfolios and realign businesses. These signs of growth and expansion in the electrified powertrain segment could result in consolidation activities as well as investment from nontraditional players and strategic realignment of businesses among traditional suppliers looking to take advantage of the market. At the same time, some suppliers could face increased pressure as revenue and profit pools in traditional powertrains and related segments diminish.

Shared mobility

The utopian vision of a future of mobility where fleets of shared autonomous vehicles rule the road is more than likely coming, although the debate among experts rages on as to when (and where in the world) we will first see that vision unfold at scale. Still, the technologies and business models that will lay the foundation on which that future will be built are already implemented today at scale. According to our analysis first published in *The future of mobility: What's next?*,[9] in the United States, we will see continued growth in total miles driven over the next 20–25 years. However, share mobility miles—whether driver-driven or autonomous—will continue to grow and account for an estimated 80 percent of total miles driven in the United States by 2040.[10] That same analysis also estimates declining vehicle sales in the United States as much as 40 percent by 2040, driven by the movement of populations to urban centers and increased cycle and usage rates as vehicle quality and functionality continue to converge.

Technology convergence

Significant shifts in vehicle technology and the rise of complex electronic content are leading to commoditization in some traditional segments, and driving growth opportunities in other, more leading-edge segments such as autonomous drive systems, advanced driver-assistance systems, electronics, and infotainment. As vehicle software content has increased exponentially as a proportion of overall vehicle content over the last decade, the value of products associated with software systems has risen while at the same time driving commoditization and flattening growth in previously high-value "hardware" segments. This segment-level divergence in growth and commoditization risk have resulted in shifting value creation opportunities that emphasize data- and service-driven offerings. Additionally, as the technology convergence continues, industry players will face very different talent and capability demands, which could drive different talent and workforce strategies.

New entrants

Players from big tech and other industries are investing heavily in automotive, putting pressure on traditional automotive suppliers to innovate quickly, something that for many, until recently, required product development cycles of three to five years or longer. New entrants in the automotive value chain are experts at driving rapid innovation and are also flush with cash relative to traditional suppliers. They own massive market caps and have not been shy about deploying capital and acquiring assets to continue advancing the technology curve. This places increased pressure on traditional suppliers to remain profitable and competitive through a demonstrated ability to drive innovation that delivers shareholder value returns.

Disruption to the traditional automotive value chain is also an emerging byproduct of new players entering the automotive segment, transforming the automotive value chain from a linear model to an integrated web where multiple companies

across multiple tiers and segments are contributing content (hardware and software) to an ecosystem of connected systems inside the vehicle. As new entrants threaten to capture significant revenue and profit pools, success will likely hinge on a company's ability to capture value in the new integrated web value chain of tomorrow.

Converging forces will impact players throughout the ecosystem

All players in the automotive and emerging mobility ecosystem will more than likely be impacted as the forces described above continue to exert pressure on OEMs, traditional automotive suppliers, and new entrants. There are multiple examples illustrating how OEMs are proactively embracing these disruptive forces and pivoting investment capital to new areas to help them reshape and succeed in the changing automotive ecosystem. In 2018, Toyota and Softbank teamed up to form Monet Technologies in order to develop autonomous vehicle technologies, and in March of 2019, Honda announced it will also invest in the joint venture. This year it was also announced that Ford has invested US$500 million in Rivian, an Amazon-backed e-truck startup, and that General Motors invested US$300 million to produce new EV line based on advanced Bolt architecture.

Traditional automotive suppliers are not standing idly by. Since 2015, there have been dozens of examples of traditional automotive suppliers consolidating to reduce cost and/or quickly win market share as well as restructuring or spinning off operations to increase their capability to focus on—and take a competitive advantage—in core areas strategic to the business and objectives to drive growth and shareholder value. Meanwhile, new competitors are rapidly redefining the market, challenging traditional business models, and forcing all traditional players to adapt to the new ecosystem. In June 2017, Delphi Automotive split into Delphi Technologies and Aptiv, allowing both companies to pursue divergent growth paths and adopt more focused strategies congruent with new lines of business. In October 2018, Tenneco acquired Federal-Mogul, and split the combined company into Aftermarket/Ride Performance and Powertrain Technology, allowing both to benefit from the added scale and strategic flexibility. Most recently in March of 2019, Continental announced plans to spin out its powertrain business; proceeds from the sale are expected to be invested into developing software capabilities.

Compounding all of this is the looming forecast for a pending economic downturn. Like the Great Recession, the industry will likely suffer in the near term while also creating significant opportunity for agile companies to grab market share and reposition businesses that align with long-term market and consumer trends. Also, like the last downturn, players—OEMs, traditional suppliers, and new entrants—will emerge with divergent trajectories. What the last downturn and previous Global Automotive Supplier Studies reveal is that successful players will likely be those that diversify risk across markets, products, and even customers, while those that are slow to innovate against new competitors and restructure costs will likely be at a significant disadvantage.

Divergent futures: Growth, stagnation, and declines across supplier segments

Our analysis and segmentation of the current automotive supplier landscape show the magnitude by which current segments are either poised for growth or decline. According to CapIQ, the total combined revenue of the global automotive supplier market was US$1.7 trillion in 2018. Furthermore, our segment analysis estimates that some segments could face as much as 20

percent in revenue erosion over the next five to seven years while, on the other hand, some higher-growth segments could more than triple their current revenues.

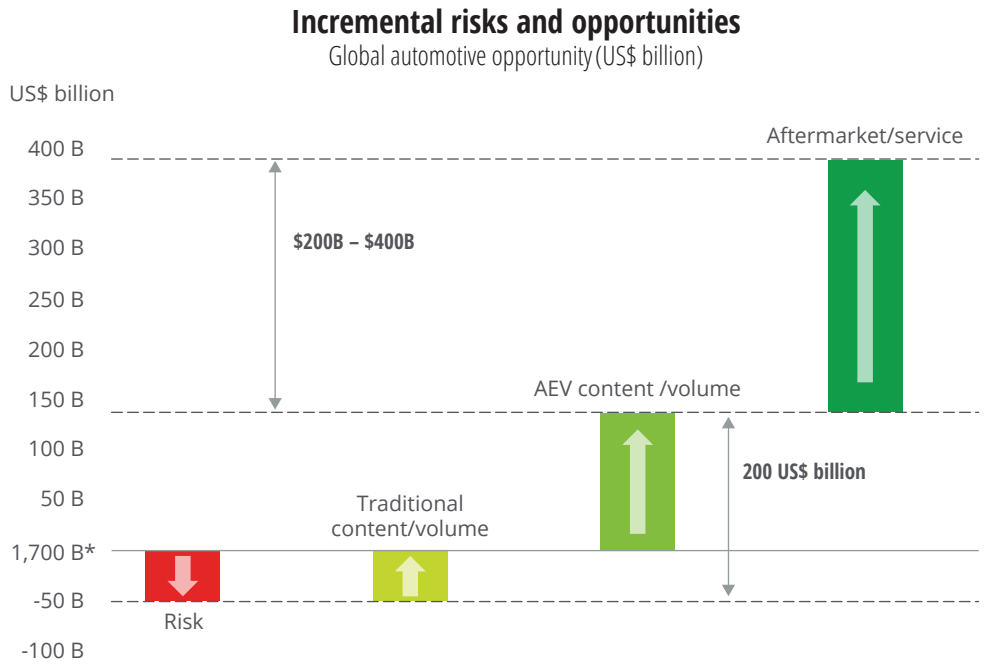
However, each part of the automotive ecosystem is impacted differently by the forces driving disruption and transformation, leading to a future where outlooks diverge based on the segments in which suppliers choose to operate. As we learned from the Great Recession, some suppliers thrive while others will struggle. For example, suppliers driving innovation in autonomous and electrified systems will likely see the most opportunity and growth (as much as approximately 300 percent in some segments), while those operating in more commoditized automotive supply segments such as frames, interiors, brakes, and internal combustion engine could be most at risk as these segments stagnate and decline between now and 2025. In addition, segment attractiveness will not only be dependent on the product segments in which suppliers operate, but also on the growth potential and their ability to differentiate (figures 2 and 3).

In this year's *Global Automotive Supplier Study*, we categorize product segments as growth, stagnant, and declining, and provide three moves—expand, defend, and pivot—that suppliers can consider in each segment.

FIGURE 2

Segment attractiveness: Differentiated future for traditional automotive suppliers

Our segmentation of the current landscape shows the magnitude by which current segments are poised for either growth or decline

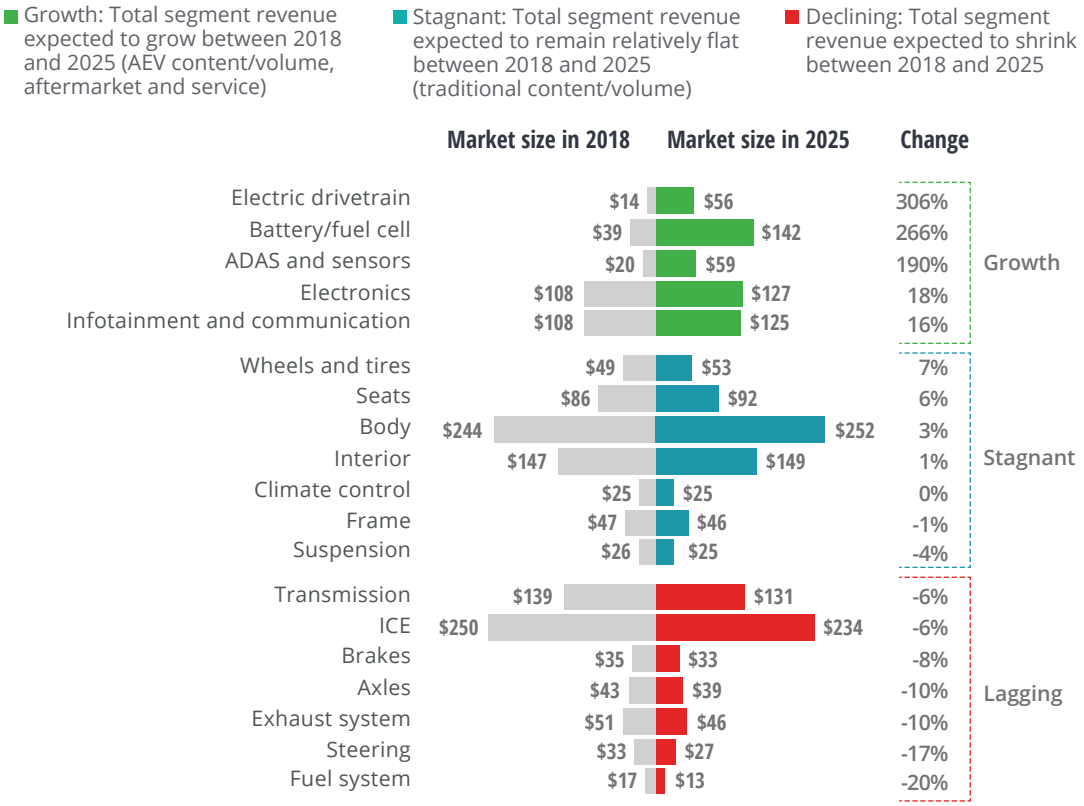


*Based on 2018 year-end reported revenues from CapIQ.

FIGURE 2 *continued*

Content mix by revenue

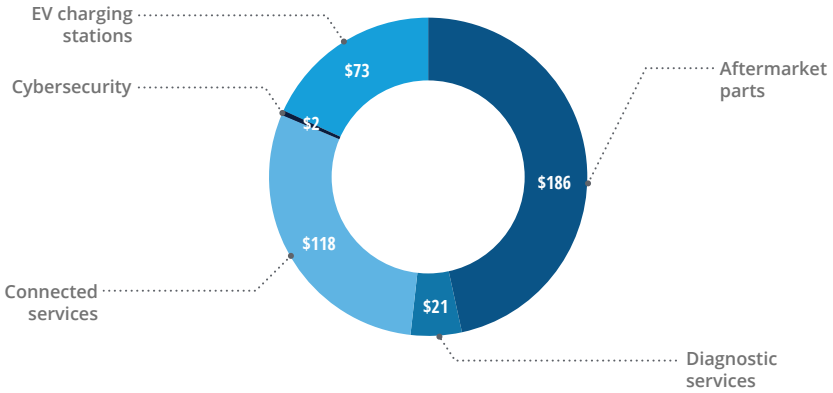
Projected segment market size (US$ billion)



Note: Market size for each segment was calculated based on the 2018 IHS Markit data for more than 280 traditional suppliers and technology companies. Each company was assigned to a segment based on its product mix and the main source of revenue. The 2018 revenues were based on actuals and the 2025 revenues on IHS Markit projections as of 2018. ADAS denotes advanced driver-assistance system. ICE denotes internal combustion engine.

Aftermarket and service revenue

Projected incremental market size (US$ billion)



Note: Connected Services includes M2M, OTA updates, and infotainment services such as apps, on-demand audio/video, and ads.

Revenue growth projections from 2018 to 2025 show segment performance over the next seven years. To further understand each segment, we considered other factors such as the ability for companies to differentiate themselves against direct competitors, or conversely, segment commoditization. We also assessed growth prospects for each segment using a combination of historical growth rates, Deloitte's internal research on projected vehicle sales by type, and third-party research on vehicle content mix.

Expand, defend or pivot: Making moves that matter

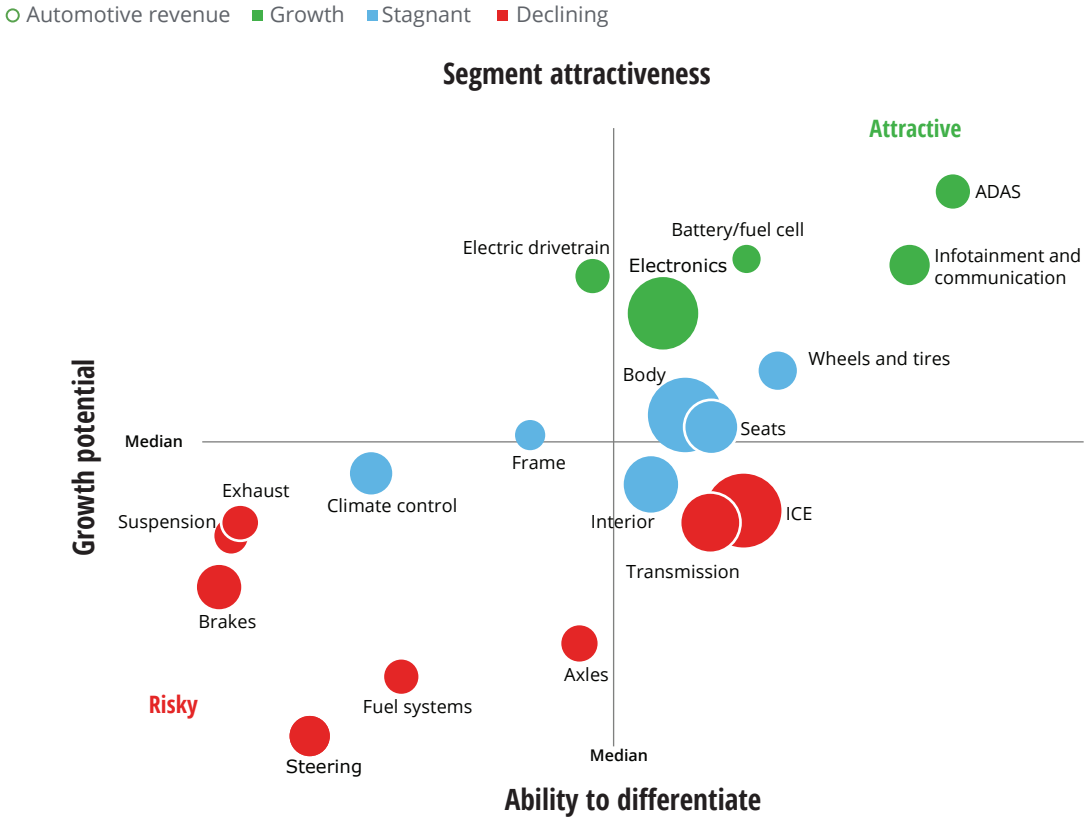
GROWTH SEGMENT

Harnessing growth through new technology and fresh product portfolios requires significant investments. Today, we see examples of OEMs, suppliers, and new entrants working together to actively develop new business models and create new business ecosystems, especially in a way that looks very much like the new integrated web value chain

FIGURE 3

Impact of disruptive forces: Differentiated future for automotive suppliers

Each part of the automotive ecosystem is impacted differently by the forces, leading to a future where outlooks diverge based on segment, as some thrive while others struggle



Note: Using the same population of companies as in figure 2, an assessment of the overall attractiveness of each segment was performed based on the growth prospects and the ability for players to differentiate themselves. To determine each segment's relative positioning, we used a combination of qualitative research and aggregated financial metrics. From a financial and quantitative perspective, the ability to differentiate was measured based on each segment's EBIT margin and trailing 3-year EBITDA percentage. Growth potential was measured primarily based on trailing 3-year revenue CAGR and also incorporated Deloitte internal analysis of projected vehicle sales by type and external research of vehicle content mix by product.

Sources: Deloitte analysis; *2019 Global Automotive Supplier Study*.

discussed earlier. Forward-thinking suppliers have also already started to reposition themselves, many making investments—sometimes through acquisition—into software and related businesses. While these new areas remain relatively small compared to the legacy business, some represent the fastest-growing units within companies. Suppliers in the growth segment seeking to expand, defend, or pivot might consider the following moves:

Expand: Develop and acquire cutting-edge technologies to preserve leadership position

Defend: Acquire competitors to increase base and maintain growth in shareholder value

Pivot: Spin off growth businesses from larger parent organizations to focus on strategic priorities and resource allocation

STAGNANT SEGMENT

Some traditional supplier segments, such as seating, body, and interiors, could face a significant change in the coming years as cars, consumer behavior, and expectations evolve. Still, the utopian vision of the future of mobility does offer opportunity for suppliers in these and other segments that are able to drive product innovation and differentiation. Not everyone will win. In fact, there are already examples of how uncertainty within these segments has caused several companies to financially underperform in recent years. Still, in a future where shared autonomous vehicles rule the road, innovations that deliver, for example, on customer preferences for customized, private, and configurable interiors and personalized climate zones, offer pathways to innovation and growth. This is, however, subject to investments in research and development being strategic and operational efficiencies contributing to cost containment and reduction. Suppliers in the stagnant segment seeking to expand, defend, or pivot might consider the following moves:

Expand: Shift investments toward growth segments and focus resources on high-return product areas

Defend: Acquire or merge with peers to improve scale benefits and maximize cash flow in stable or lagging segments

Pivot: Align on a long-term strategic direction for the organization and divest business units and/or products that do not contribute to the strategy

DECLINING SEGMENT

Not too surprisingly, declining product types have been trending toward commoditization in recent "years" and companies playing in these spaces have already started to use scale in order to harvest profits and ensure they can maximize cash flow through the product decline life cycle. There are examples of suppliers splitting their "growth vs. harvest" businesses, and the industry is likely to see more mergers and acquisitions to drive consolidation in these declining segments. Financial investors could emerge as potential consolidators in some of these segments, but the ability to scale and lead on cost will be a key driver of financial performance in these segments. Suppliers in the declining segment seeking to expand, defend, or pivot might consider the following moves:

Expand: Invest in developing markets with less technological advancements

Defend: Harvest remaining shareholder value within lagging businesses by consolidating and leveraging scale

Pivot: Sell struggling businesses to competitors or private equity buyers to allow for a more radical overhaul

What now?

Despite the uncertainty of what the future holds and when that future will arrive, there is a certainty that the market is not waiting to find out, even though the impact of the transformation could be exacerbated by prevailing economic headwinds in markets around the world. We have enumerated examples of OEMs, suppliers, and new entrants making strategic moves that clearly signal continued transformation and disruption lie ahead. Clearly, this not the time to twiddle thumbs, especially for C-suite executives. We believe this ever-evolving ecosystem gives executives a useful context to think about the portfolio of businesses in which they currently operate and various likely trajectories for their businesses in the future. They can establish which businesses they should be in, which businesses they should harvest or divest, and which ones they should fund for growth. They could strategically plan on whether they want to defend their market position or, say, consolidate certain businesses for scale and cost leadership, and how. In this transforming industry, there will be numerous, and many new, ways to generate superior performance and shareholder value. Ultimately, all the turmoil boils down to one simple question: how should you get prepared to successfully navigate your organization through the massive transformation and disruption that is already underway and likely to last for decades to come? The answer could well lie in deciding what you want to expand, defend, and pivot.

Endnotes

1. Deloitte, *2013 Global Automotive Supplier Study*, 2013.
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