



# Automotive Supply Chain Risk Assessment

Supply Chain Health:  
An ounce of prevention  
is worth a pound of  
cure

For decades, automotive executives have searched for ways to cut costs. One of the more popular methods has been to demand price breaks from suppliers. The thought behind this approach seemed logical — “force” efficiency into the supply chain by making suppliers reduce costs, and thereby reduce costs for automotive companies and allow them to stave off the competition and make a better margin. For the most part, this technique has worked to reduce costs for automotive companies, **but at what price?**

In today’s world, supplier margins have been stretched as thin as they’ve ever been as piece prices and volumes continue to fall. Now, suppliers are being asked to do even more — engineering and product development, systems development and delivery — as well as invest in people, processes and new technologies to better serve their customers and stay competitive.

And if that isn’t enough, suppliers are also being asked to source products from emerging countries and follow their customers into those markets. This often requires suppliers to carry additional inventory to ensure product delivery, as well as bear the burden of added cost to carry the inventory from the emerging markets to the supplier. Add into the mix the fact that some of the products coming over are not up to suppliers’ — or customers’

— specifications, which causes costly rework and risks to product delivery.

Can automotive companies mitigate these supply chain risks? Is there any way to predict where the next weak link is and strengthen it before it breaks the chain? Is there a way to determine the health of suppliers? Can companies diagnose the problem before “major surgery” is needed?

PricewaterhouseCoopers works with many forward-thinking companies on these issues, and understands that, in the long run, companies benefit from not having to fix a troubled supplier and from being able to predict where the next weak link is in a supply chain. Here are some of the techniques we recommended to our clients.

1. Model the supply chain so that you have a clear understanding of what it looks like and how it operates. Unlike other complex manufacturing businesses, automotive supply chains are deep and broad. It is essential to understand the make up of all tiers along with potential bottlenecks and risks of supply interruption and quality problems.
2. Determine the relative “health” of each of the suppliers within the chain to determine where the highest risks exist.
3. Prepare a corrective action plan that will head off a breakdown in the chain and avoid the expensive cost of crisis management. Suppliers with financial problems can often be returned to stability through process improvement, pricing adjustments or by reducing the cost of capital. In addition, customers may be able to guide troubled suppliers to other stronger auto suppliers or to private equity in order to strengthen balance sheets and improve management.
4. Establish a proactive monitoring function that collects information from suppliers, from customers and from independent third parties. The monitoring function should “score” the members of the supply chain and objective measurements and produce predictive information. In addition, a well designed monitoring function can provide management with an enterprise-wide measure of the company’s supply chain risk profile. Such a measurement technique can be used to monitor progress in reducing overall supply chain risk.

Determining the “health” of suppliers in a given chain requires some detailed financial and operational data. However, simply sending out questionnaires and collecting information is not enough. Questionnaire feedback is important, but must be followed up with a “physical exam” to ensure an appropriate “diagnosis.” Companies must also determine how the supplier compares with competing suppliers. Trends should also be considered. Simply looking at a supplier’s “test results” at a particular point in time doesn’t reflect whether the supplier is getting better, getting worse or maintaining its relative health.

This approach to examining the health of a supplier includes two components — measuring performance over time (the Trend Score) and measuring the current state of the company (the Absolute Score) for key financial and operational variables.

After a company determines the right course of corrective action for the supplier, it must conduct regular “checkups.” Periodic reviews of the supplier’s financial and operational information will help determine if additional corrective action is required. Once the supplier has moved to “stable condition,” the company can focus its attention on other weak links.

Based on our experience, companies that identify the possibility of supply chain disruption and take corrective action before a crisis occurs maintain a much lower “cost of risk” on an enterprise-wide basis. The key is to monitor supply chains using proven tools and techniques that will ensure that potential risk is being addressed proactively.

## About Automotive

PricewaterhouseCoopers’ Global Automotive Practice is the world leader in risk management consulting for the automotive industry. In addition we are the auto industry’s leading provider of assurance and tax services. Global reach is a critical success factor in the world of the automotive industry. It is an equally critical success factor for professional services firms serving global companies. That is one reason why PricewaterhouseCoopers – the largest professional services firm in the world – is well-positioned to serve the automotive industry. With more than 140,000 people worldwide in 149 countries and territories, we have a significant presence in every major market. Our firm is a global powerhouse – a Tier One supplier – with unmatched global reach and ability to serve automotive clients.

The importance of these facts is that clients of PricewaterhouseCoopers can count on us to know the automotive industry and to deliver efficient, effective, and pragmatic service and insight.

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