DETROIT'S DEMISE STEMS FROM FLAWED SUPPLIER RELATIONS

By

David N. Burt, Ph.D. & Robert Porter Lynch November 28, 2008

During the past weeks, several causes of the present sorry state of the American auto industry have received much attention: shoddy/incompetent management and inflated wages and pension expenses. But one critical cause seems to be ignored: the impact of ***adversarial relations*** with the "Big Three's" supply bases.

To put things into perspective, 60 – 80% of a car's cost can be traced back to purchased components and subassemblies. Thus suppliers actually provide a wide majority of the elements that go into today's car. One might expect that this reliance would result in a highly cooperative relationship between auto manufacturers and their mission-critical suppliers.

However, such is far from the case. Numerous studies[i] have continually found the U.S. automakers beat up on their suppliers, treating them as "enemies" rather than trusted alliance partners. On the other hand, the Japanese car companies here in the U.S. take the opposite approach. Seeing their suppliers as an integral part of their business, Toyota, Honda, and now Nissan, work closely with their suppliers. They engage in lean manufacturing processes together and take a win-win approach to negotiations. The result: U.S. suppliers channel their new innovations and best quality systems to their Japanese customers, while the Big Three rattle their sabers demanding more cost reductions. This is how the Japanese have stayed profitable, while their Big Three counterparts together lost a whopping $100 billion since 2005. We estimate that fully half of this loss can be attributed to the failure to communicate, build trust, and engage in collaborative innovation and continuous improvement.

The Japanese approach has many of the attributes of alliances: transparence, collaboration, trust, and a joint focus on driving cost, time and defects out of the relationship. These alliance relationships allow the Japanese firms to receive 10 – 20 times the inflow of innovative ideas and improvements as at the American Big Three!

Because innovations in technology and process improvements are so critical to creating competitive advantage, Detroit's outdated strategy of "squeezing" the supplier for the lowest possible purchased price has backfired.

Interestingly enough, we have isolated examples that have demonstrated ~~of~~ the power of alliances in Detroit: Chrysler in the mid 1990's, Saturn during its first four years and G.M.'s Onstar division.

When Chrysler, under the enlightened leadership of Tom Stallkamp in the early 1990's, employed a collaborative approach with its supply base, costs were reduced by some $7 billion, product development time was reduced significantly and the flow of innovative ideas from suppliers increased many fold. Chrysler revived, gaining so much new value that it attracted a buy-out by Daimler. Unfortunately for all, Daimler then rejected Mr. Stallkamp's approach since it was not consistent with Daimler's traditional adversarial approach to supplier relations. Shortly thereafter Chrysler was loosing money again.

Saturn was on its way to becoming a poster child of collaborative alliance relations with its supply base when "enlightened" management at corporate headquarters said: "wait a moment, this does not fit the GM model of supplier bashing." Exit alliances.

G.M.'s OnStar has managed to survive and thrive ~~in its~~ using a somewhat renegade collaborative approach to the use of alliances. In fact, a recent audit by a G.M. team of auditors was so impressed with OnStar's approach that it recommended the approach be applied to all of G.M.! Of course, such an idea is foreign to senior management's mind set. (It will be interesting to see how long OnStar survives in its present approach to supplier relations, assuming that its parent survives!)

Working collaboratively to create innovation flows from suppliers is not antithetical to American companies. Procter and Gamble, under the agile leadership of A.G. Lafley, now receives over 50% of its innovations from outside sources, much coming from win-win relationships with its suppliers.

In order to regain our ability to compete in the modern global industrial world, we MUST embrace a collaborative approach to dealings with our supply bases. Thus, IF the American people are to continue investing in the survival of the Big Three (or any part of it) we must be more proactive and insist that our investment has the prospect of achieving its desired objective! And to achieve the objective of competitiveness, Congress must direct recipients of any more "loans" to embrace collaborative alliance relations with their supply bases!

Since collaboration and alliances are foreign to most managers' ways of thinking:

- Congress must mandate the adoption of an alliance approach to relations with the Big Three's supplier bases.
- Management at the Big Three MUST develop a plan to gain the benefits of alliance relations with their supply bases.
- This plan must include:
    - education of the first two tiers of management on the benefits and principles of alliance management (within 3 months of receipt of bailout funds)
    - development of an implementation plan (within 4 months)
    - quarterly action plans (4 months)
    - quarterly reports on results in the areas of;
        - total cost of ownership
        - quality
        - time to market

- service/support
- inflow of innovative concepts

- Feedback from suppliers on their relationship experiences with their OEMs

Implementation of a collaborative approach to dealing with the Big Three's supply bases is every bit as crucial to their survival as are upgrading management and reducing salaries, wages and retirement expenses. In some ways it is more challenging since so many managers seem obsessed with "screwing" the supplier instead of collaborating with him to advance their common interests. We can only hope that Congress will be able to force the implementation of this enlightened approach to supply management on Detroit!

David N. Burt, Ph. D. is Professor Emeritus of Supply Chain Management at the University of San Diego. Dr. Burt has over fifty years as a practitioner, instructor, consultant and author.

---

[i] PPI studies from 2004-2008

Jeffrey Dyer's study of the auto industry

(Big 3 vs. Toyota/Nissan):

–High trust = low transaction costs (21% vs. 47% face-to-face interaction time).

–High trust = low procurement costs (employee productivity).

–High trust = high communication/ innovation (3 to 1 level in confidential information sharing)

–High trust = more dedicated assets.

Kumar's study of an auto parts manufacturer and its retailers:

–Retailers that trusted the manufacturer:

- –Were 12% more committed to the relationship
- –Were 22% less likely to have developed alternative sources of supply
- –Generated 78% more sales
- – Were rated top-performing dealers

Lane & Bachmann study of first-tier component suppliers in auto industry (Japan, USA & Europe):

–High-trust suppliers controlled costs better in Japan.

–High-trust suppliers defended their profit margins better in the USA.

–High-trust suppliers were better at JIT delivery.

–High-trust suppliers were better at joint continuous improvement.