

Cut-price innovation?

goetzpartners GEAR study –
General Enhancements for Automotive Supplier Relationships



2013 / 2014

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We would like to thank all those who took part in the in-depth survey on collaboration between automakers and suppliers, as well as Ruben Strenzke and Eva Gremmer for their valuable contribution.

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Executive summary

The “GEAR study – General Enhancements for Automotive Supplier Relationships”, an in-depth survey of more than 100 participants from the automotive supplier industry, aims to cast a light on the relationship between automobile manufacturers and suppliers: how do suppliers rate overall the collaboration with OEMs along the entire value chain – and where do they see potential for improvement? Are they perceived as a partner that offers the manufacturer genuine added value by virtue of their wide-ranging project experience and their innovative strengths? Or are manufacturers simply looking to outsource certain services for financial reasons and accordingly squeeze suppliers on price?

Jaguar Land Rover is seen as particularly loyal, cooperative, and reliable in its dealings with suppliers, while German manufacturers Audi, BMW, Mercedes-Benz, Porsche, and VW achieve very good results overall. Aspects such as price would appear to be the priority among the other European and Asian marques where suppliers rate collaboration overall as less driven by a spirit of partnership and more geared to financial considerations.

Main areas of concern voiced by suppliers include:

- Supplier innovations are often no longer suitably rewarded
- Integration in manufacturer projects is often too late
- Manufacturers do not draw sufficiently on the suppliers’ wealth of experience in project work
- Excessive weighting on price as the selection criteria does not automatically translate into success among manufacturers

From the suppliers’ standpoint, manufacturers that forcibly dictate prices only stand to walk away with a better deal over the short term. A long-term supplier relationship, however, tends to pay off much more, with suppliers seeing themselves as innovation drivers – providing their partner on the manufacturer side lets them. Whatever specific form the collaboration takes, mutual trust and respect remains one of the key elements in a sustainable supplier relationship between OEM and supplier.

Five central propositions emerge for successful long-term collaboration between both parties:

- Groundbreaking: benefit from the suppliers' innovativeness and reward this suitably
- Ongoing: further develop project work and thus bolster partnerships
- Balanced: create win-win situations – not just price, but also quality and innovation should be decisive
- Long-term: do not bring the partnership to an end with the volume-production phase
- Sustainable: build on partnerships with strategic suppliers

1 Methodology

As part of the in-depth study, a detailed questionnaire surveyed 117 participants from the automotive supplier industry on the status quo of their manufacturer/supplier relationships. Two thirds of the respondents come from companies with annual sales under €200 million, 14 percent from companies with sales in excess of €3 billion per year. Companies in the single-digit percentage range account for the remaining 20 percent, spread across the bands from €200 to €500 million, €500 million to €1 billion, and €1 to €3 billion.

Owner-operated companies or family-run businesses (33 percent) as well as listed joint-stock companies (40 percent), and investor-managed companies (13 percent) took part. These firms fall into seven segments: Chassis, Powertrain, Exterior, Interior, Electric & Electronics, Infotainment, and Safety.

Just under one third (30 percent) of the individuals taking part hold top management positions (senior management or Board of Management as well as divisional or segment management); the two largest participant groups are employees from the areas of sales and marketing (26 percent), and quality management (22 percent).

The surveyed companies rate their financial situation as sound. Around two thirds stated that their sales had outperformed the industry average over the past three years. The EBIT margins are mainly in the region of three to six and six to ten percent. One out of four companies posts an EBIT margin in excess of 10 percent.

2 Foreword

3.1 German premium manufacturers face pressure to innovate

The good old days of the German car industry are not all that long ago: the best engineers were working away flat out, to the point of obsession at times, on improving the vehicles – reinforcing the nonetheless legendary reputation of cars “Made in Germany” around the world. Revolutionary innovations such as the anti-lock braking system (ABS), power steering, or more recently the eight-speed automatic transmission were regarded as cutting-edge technology in their day and are – say in the case of ABS – now standard features in low-end compact cars from eastern Europe or Asia. Marketing slogans such as “Sheer Driving Pleasure” or “The Ultimate Driving Machine” and “Vorsprung durch Technik” have become a byword for quality around the globe.

Yet the automotive industry is much more than an important standard-bearer. It is also a fundamental economic factor: the German automotive industry generated sales totaling €357 billion in 2012, equivalent to around 20 percent of the German economy’s total sales. Automobiles and automobile parts are by far Germany’s most important exports, accounting for a volume of around €190 billion. The automotive industry also provides a large part of the investment, and not just in property, plant, and equipment: “The automotive industry is the most research-friendly industry in Germany,” said Federal Chancellor Angela Merkel during the inauguration of IAA 2013. “It accounts for around a third of all research investment of the German economy. As such, it is an important innovation driver and partner in bringing Germany closer to its goal of spending three percent of gross domestic product on research and innovation. The German automotive industry is also the pioneer and innovation powerhouse for other industries.” And meanwhile Stuttgart, Munich, Ingolstadt, and Wolfsburg are reporting record-breaking figures virtually every quarter, thanks to a constant increase in sales, revenue, and profit.

Despite these positive financial numbers, developments are emerging which – if this trend continues unabated over a longer period or even gains momentum – will undoubtedly have the potential to cause the powerhouse of German industry to stall. Apart from the constantly rising tide of regulations imposed on the German automotive industry worldwide, domestic causes also pose their own threat, especially as far as innovation management with suppliers is concerned. After all, where real innovations are involved, we are clearly seeing on occasions, albeit admittedly not yet that often, that innovations no longer celebrate their premiere in German premium vehicles, but are embraced first by the competition – say in the entertainment segment.

One important reason for this development is tied up with the changed business model of the German automotive industry with constantly dwindling vertical integration – the OEM buys in up to 80 percent of the value creation of a vehicle – coupled with increasing short-term cost pressure on suppliers. In this environment it is becoming increasingly difficult to push forward innovations jointly and reward them suitably. Yet this is precisely what the German premium manufacturers urgently need, as it is the only way they can justify premium prices. For the most part, however, it is the suppliers that provide the innovations – and one entirely realistic scenario is that suppliers will be more inclined in future to take their innovations to high-volume automakers, enticed by the prospect of better margins on the back of higher volumes.

Over the short term, this development will certainly not cause the “economic powerhouse of the automotive industry” to stall; the trend is still not pronounced enough for that, but things would seem to be heading in that direction – with no one really willing to take evasive action. Nonetheless, there would still be time to get things back on track.

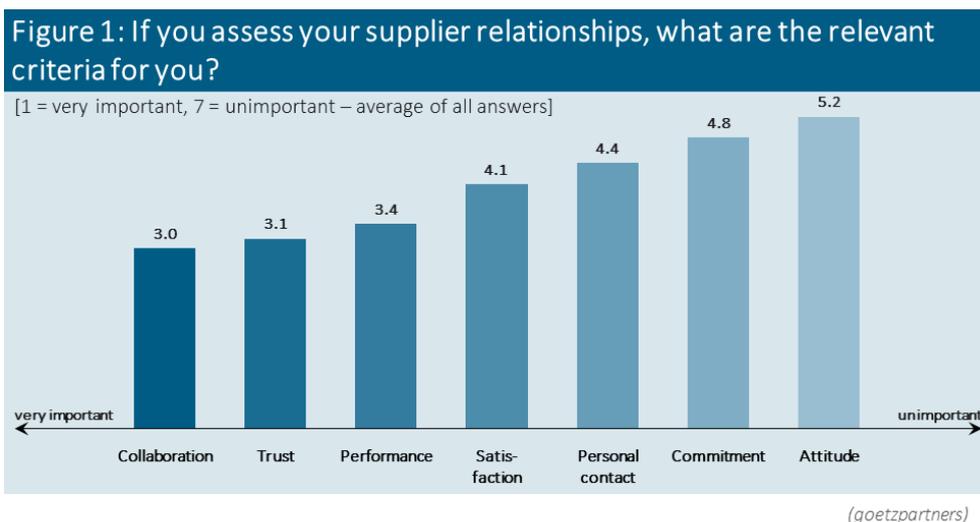
3 Study findings

3.1 Trust is good, trust is better

Soft criteria tend to define the supplier relationships even in the technology- and numbers-driven automotive industry, the global flagship of the German economy, with its no-holds-barred attitude to competitive advantage hitherto: ‘collaboration’ between supplier and manufacturer as such takes center stage, as both work together on a specific project. The basis is the ‘trust’ between the project partners that underpins the entire value-creation process – from the early phase of development through to the volume-production phase.

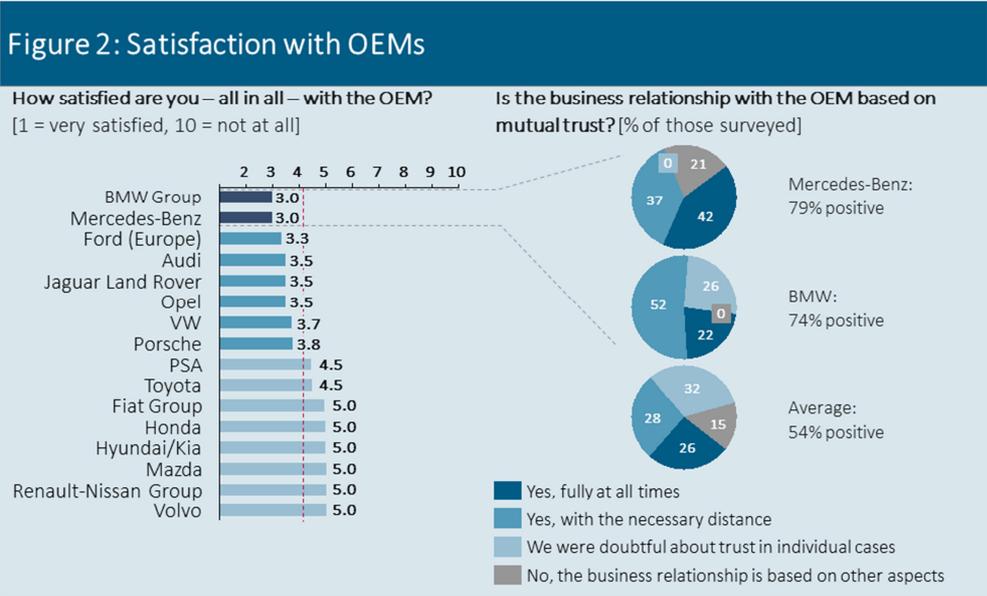
Back in third place is the hard criterion ‘performance’ which includes aspects such as price, quality, deadline and delivery compliance. Of course, prices are always an important benchmark when awarding the project, especially as they tend to be the easiest to compare – and there are also certain manufacturers that award contracts solely on this basis, according to suppliers. Yet this tends to increasingly involve companies that are exposed to huge price pressure as their businesses flounder – and that do not (or no longer) embrace technical innovations either.

While the gap between the two key criteria ‘collaboration’ and ‘trust’ and the characteristic ‘performance’ is not huge, it clearly exists. The manufacturer’s personal contact with and commitment to their business partner prove less important, though. Seven criteria were surveyed in total which were used as the basis for ranking participants (Figure 1).



Manufacturers scoring very high trust figures from those surveyed also lead the field overall in terms of satisfaction. Asked whether the business relationship with the manufacturer is based on mutual trust, the bulk of those surveyed responded positively with Mercedes-Benz (79 percent) and BMW (74 percent): trust exists “fully at all times” or “with the necessary distance”. On average this figure stood at 54 percent across all manufacturers.

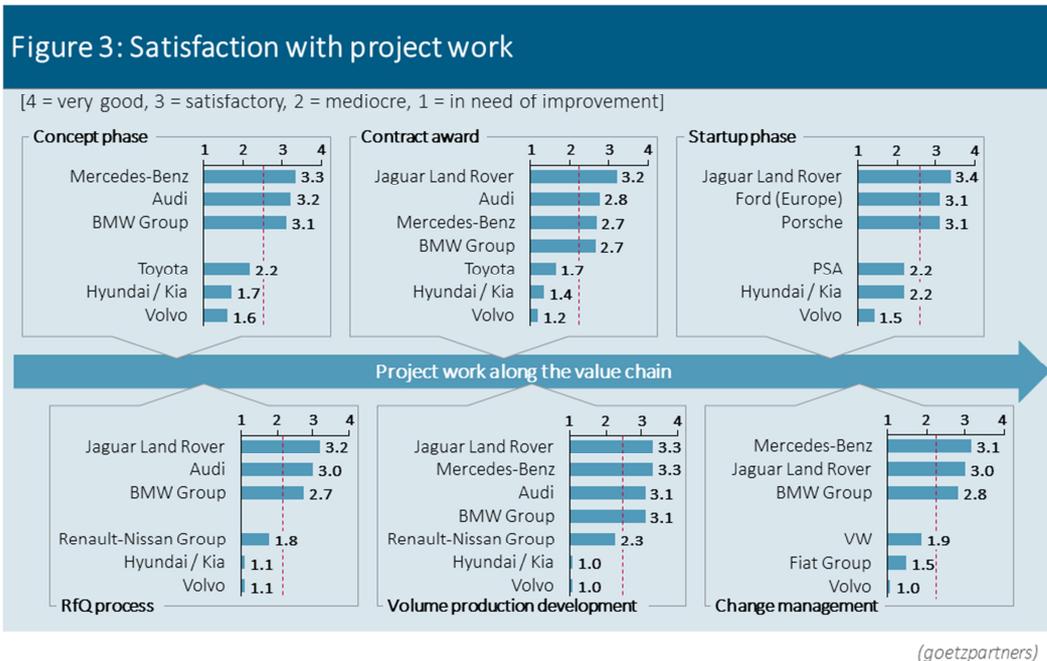
With the question on satisfaction the two German premium manufacturers came out on top with an average of 3.0 (1 = very satisfied, 10 = not satisfied at all). On average all 16 quoted manufacturers scored 4.1 here – equivalent to a figure of around 54 percent.



(goetzpartners)

3.2 Collaboration in project work: Jaguar Land Rover compelling

The relationship between supplier and manufacturer starts with the project work – from the early phase through the RfQ and award process to volume-production development and the startup phase. The study participants were asked to rate collaboration with manufacturers throughout the entire project cycle.



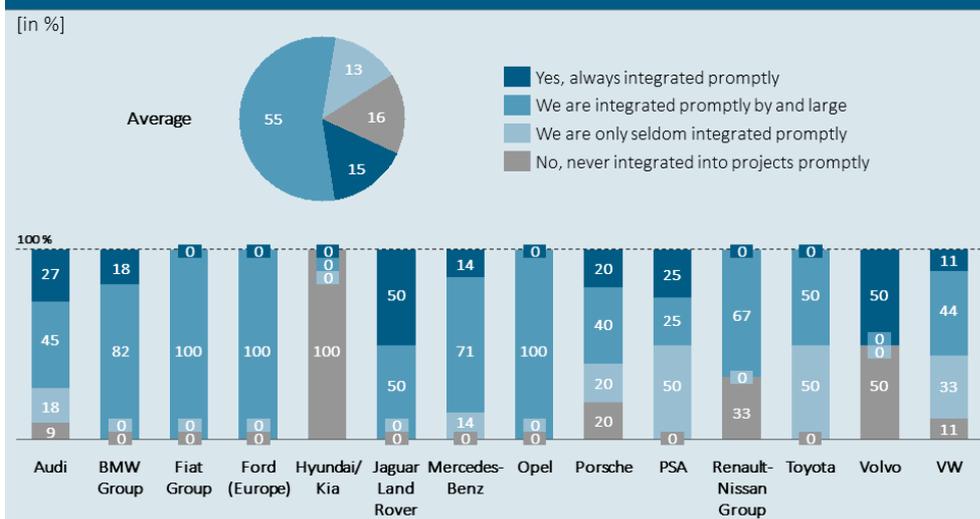
On average, Jaguar Land Rover leads the rankings here. Except for the initial concept phase the participants clearly rated collaboration in projects with the British manufacturer as the best. The other rankings in the top group vary across the individual questions. One trend does emerge, however: the German premium manufacturers in particular (Audi, BMW, Mercedes-Benz, Porsche, and Volkswagen) are already well placed here and usually get into the top 5. Another finding shows that the Asian manufacturers and Volvo, which is controlled by a Chinese investor, tend to come at the bottom of the rankings in all phases of project work.

But even with the top-ranking manufacturers there is still potential they can exploit to make cooperation with their suppliers even more efficient: for instance study participants rated the period for the internal identification and coordination process at BMW as fairly long – and if manufacturers do not know (exactly) what they want, partners will not be able to implement this.

3.3 Late integration into projects: wealth of experience often ignored

Suppliers advocate early integration into the project work. After all, it is the only way, so the argument goes, that they could integrate their experience from the outset and ultimately speed up the identification process in the project phase. On average, however, just 15 percent of those surveyed confirm that manufacturers do this, while 55 percent feel they are integrated promptly by and large. Almost a third (29 percent), however, indicated that manufacturers seldom or never got them onboard from the outset.

Figure 4: In your opinion are you integrated promptly into projects?



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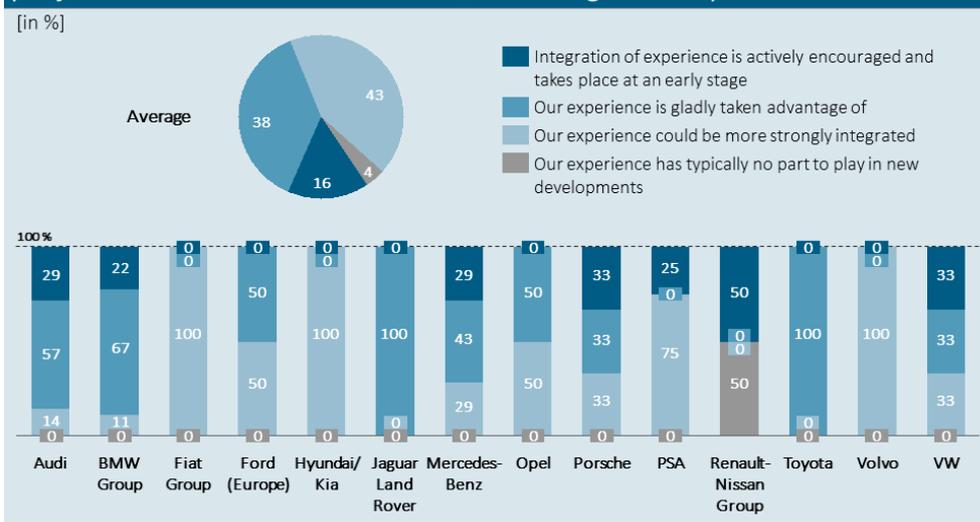
Here too, Jaguar Land Rover achieves the best score. Half of those surveyed feel they are always or by and large integrated promptly into projects. Korean Group Hyundai/Kia provides the other extreme here, with those surveyed unanimously stating that the manufacturer always leaves them in the dark in this respect. At BMW virtually all those surveyed (94 percent) see themselves in the positive area, whereas with Audi the same figure is just 72 percent – in this respect more than a quarter of suppliers feel they are always promptly integrated into the project work, which is the highest figure in this category among the German marques. Volvo provides an extreme example of the hierarchy among suppliers. While half of the study participants are absolutely satisfied with integration, the other half sees itself as complete outsiders.

In this respect the automotive groups could leverage the wealth of experience garnered by their suppliers: ultimately they are well versed in dealing with changing requirements and processes of different partners by virtue of their daily project work and occasionally have a very valuable different viewpoint on issues from the manufacturer that tends to live in their own world. For this reason, participants were asked whether in their opinion manufacturers take

into account the incorporation of experience and optimizations derived from existing projects in new or next-stage developments – so they do not have to regularly reinvent the wheel.

Jaguar Land Rover was highly receptive here too, with all those surveyed affirming that they gladly take the suppliers' experience onboard. Between 22 and 33 percent stated that the German premium manufacturers also actively promote and expect such an approach. Here, the Renault-Nissan Group achieved the highest

Figure 5: Are your experience and optimizations derived from existing projects taken into account in new / next-stage developments?



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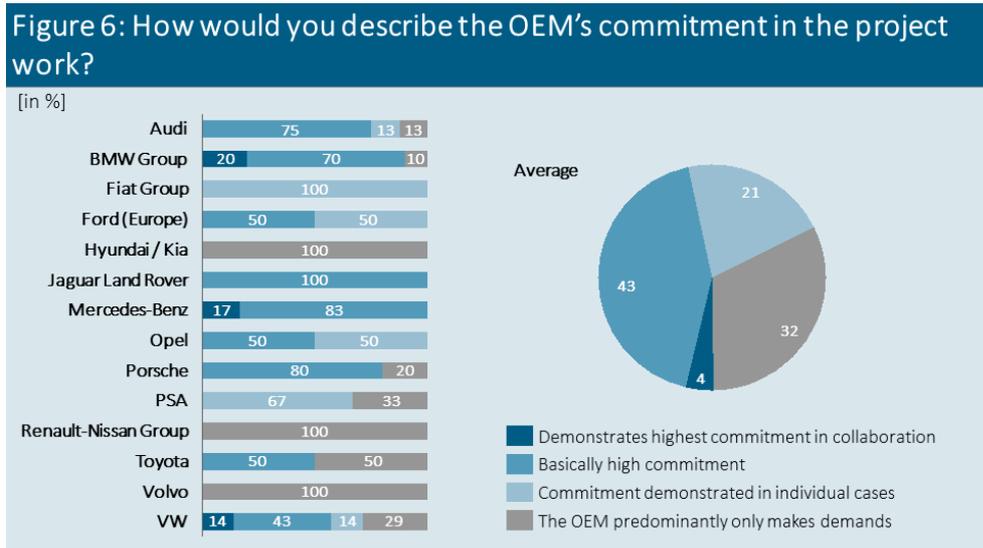
score: 50 percent of those surveyed stated that the French-Japanese Group promotes knowledge sharing. However, a “two-class society” emerges here, with a similar 50 percent believing that the suppliers' experiences were irrelevant.

3.4 Project work: BMW, Mercedes-Benz, and VW demonstrate most commitment

Collaboration in the project, the prompt integration into projects, and knowledge sharing between manufacturer and supplier can also be summarized under the notion of commitment. The supplier’s support is important in helping find buyers for the vehicles as the components of the car also make up the brand and driving experience: the display and touchscreen of the entertainment unit, an intelligent driver assistance systems, or a steering wheel that is very pleasant to the touch.

Accordingly suppliers come to appreciate the commitment of manufacturers: do they contribute to the success of the cooperation or predominantly make demands on the supplier? “The people from Jaguar are always highly committed during the project discussions – it’s all about solutions!” says, for instance, one of the study participants.

“It’s a game of give and take” – suppliers reciprocate the manufacturers’ commitment by identifying very closely with the manufacturer in certain areas, with its market presence, and with its positioning in the marketplace. By a large margin, suppliers can identify most with



Porsche, followed at some distance by the other premium manufacturers BMW, VW, Audi, and Mercedes-Benz.

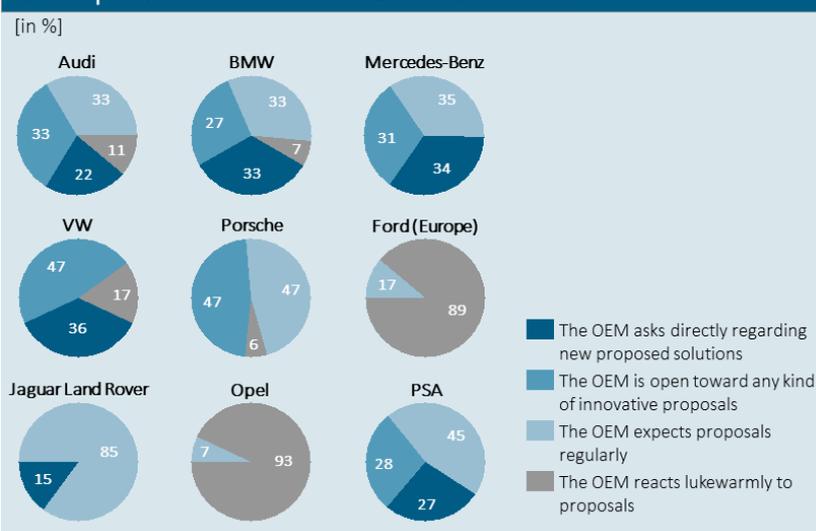
With regard to Ford all those surveyed stated they could identify predominantly with the brand image. PSA and Opel are the only two manufacturers that a portion of the study participants had difficulty identifying with. The suppliers are entirely undecided with Renault-Nissan, Toyota, and Jaguar Land Rover. This is slightly surprising insofar as the British were repeatedly singled out in the study for their dealings with and commitment to collaborating with suppliers. The change of owner over the past few years and the entry of the Indian Tata Group, which has been viewed with suspicion if anything, may well be two factors here.

3.5 Suppliers as innovators: varying requirements on the part of manufacturers

Anyone replacing their S-Class, 7 Series, or A8 with a successor model expects improved technical features. Generally, end customers are not that interested in whether such new features can now be dubbed an innovation strictly speaking. But irrespective of whether something new is only better, but innovative too, the fact is that many manufacturers fail to leverage some of their suppliers' innovation potential. These suppliers are willing to incorporate their experience and their knowledge and say self-confidently: "Manufacturers wouldn't be so successful if it wasn't for the suppliers' innovations."

Ford and Opel, on the one hand, who are unanimously regarded as responding lukewarmly to the supplier's proposals, and, on the other hand, Jaguar Land Rover, Renault-Nissan, and Toyota, who regularly expect proposals, represent the two ends of the spectrum here. The other manufacturers tend to be fairly open to new ideas and concepts. However, only half or a third of those surveyed respectively stated that innovations are actually expected.

Figure 7: How does the OEM behave in relation to the presentation of innovative solutions?



3.6 Innovations too often not rewarded sufficiently

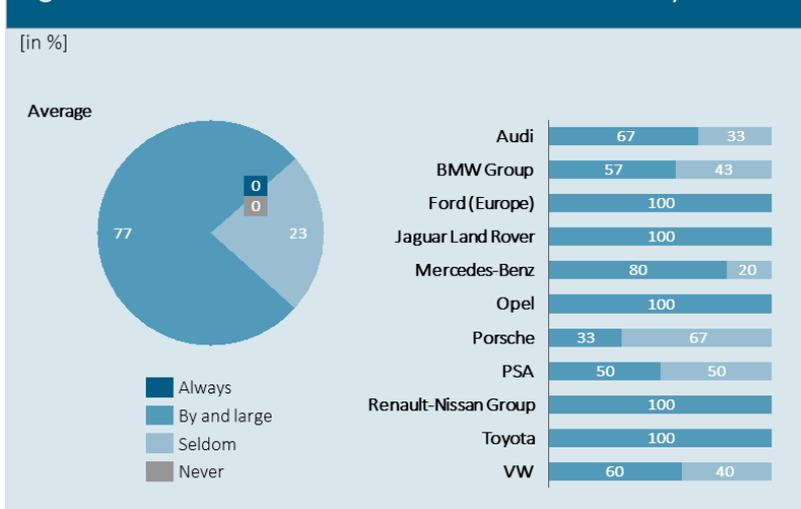
In addition to the basic willingness to listen to innovation proposals, how manufacturers deal with presented new features is decisive for suppliers: do they do so based on trust – and do they reward presented innovations suitably? One study participant mentioned one manufacturer who immediately filed their own patent on an innovation presented by the supplier. While this may be the exception, it is, however, indicative of this highly competitive key industry where at times no holds are barred.

According to all those surveyed, Jaguar Land Rover always deals with the presented innovations trustworthily, with Porsche and PSA being ranked second and third respectively here. BMW, Mercedes-Benz, VW, and Audi do the same for the most part always or by and large. A small portion of those surveyed, however, criticized the way in which these companies only seldom dealt with presented innovations trustworthily. All study participants felt this to be the case with Mazda.

The issue of how companies reward innovations is at least as important for suppliers. After all, suppliers offer manufacturers added value, which they can monetize when selling the vehicles – the same should then also apply to suppliers.

None of the manufacturers always rewards the innovations suitably – in the suppliers' view that is – although no manufacturer is totally uncooperative or unwilling in this respect either. With Ford, Jaguar Land Rover, Opel, Renault-Nissan, and Toyota all those surveyed stated that they are open to negotiation by and large. All others are at least in part seen as unwilling to reward innovation. Porsche and Renault-Nissan are regarded among study participants as particularly intransigent on this point.

Figure 8: Does the OEM reward innovations suitably?



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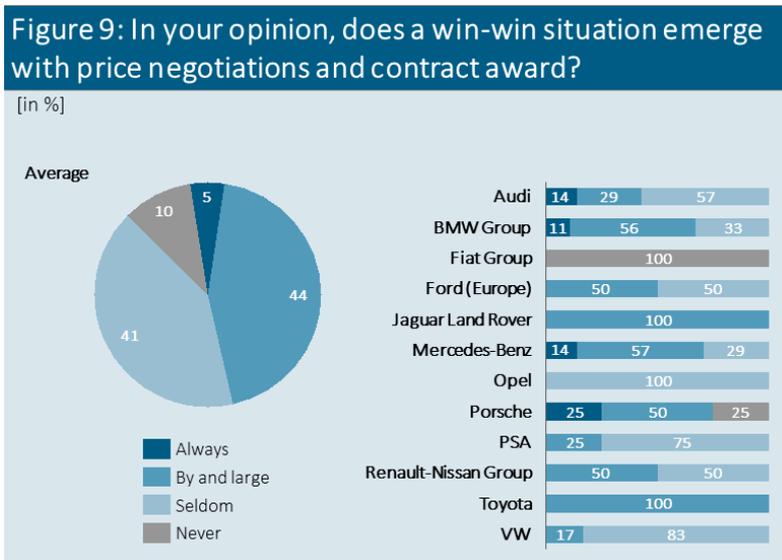
But there is no yin without yang: some manufacturers, which are slightly reluctant to reward presented innovations, are less likely to demand exclusive rights in return, enabling the supplier to market their idea elsewhere, with the

prospect of a deal with a slightly larger margin. BMW, for instance, gives two thirds of the surveyed suppliers free rein regarding secondary marketing of new ideas and concepts – putting it well above the average figure of 45 percent. PSA attaches very little importance to exclusive rights: all those surveyed said that in the French Group they seldom or never insisted on the exclusive usage of innovations. That might be due to their vehicles being synonymous with low cost rather than technical refinement.

3.7 Suppliers expect win-win situation

Climate for innovation, trust, sustainable partnerships are well and good, but at the end of the day is it not just about money? In principle, yes. But many manufacturers also attach a great deal of importance to quality performance, development expertise and – as mentioned above – innovations too. Yet price does remain an important criterion. The decisive factor is whether the manufacturer applies other criteria with the same relevance – or whether they only look at these in terms of an overall assessment of a supplier’s portfolio.

Only the Fiat Group and, to a large extent, the PSA Group work exclusively or largely on price. At Audi and VW this applies to a far lesser extent, but certain suppliers feel this to be the case nonetheless. Porsche (best figure), BMW, Mercedes-Benz, Audi – and to a small extent PSA too – are the only manufacturers that apply other criteria with an equal weighing in addition to price.



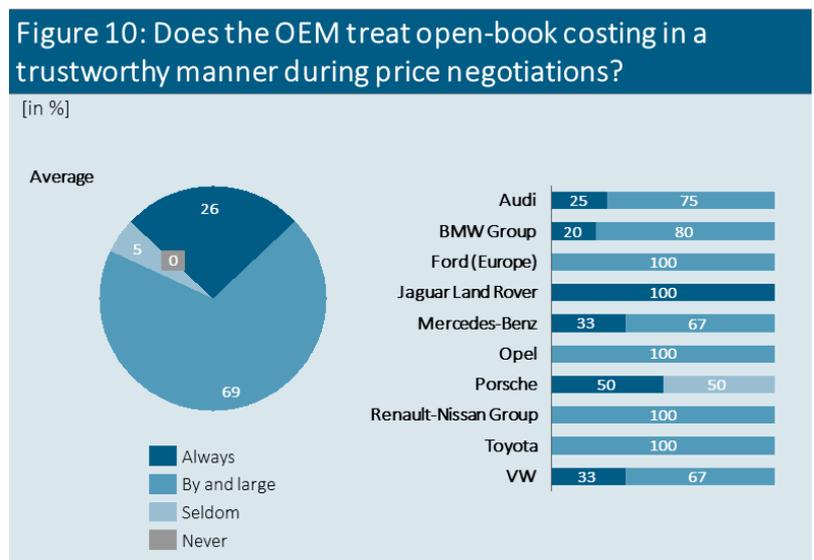
(goetzpartners)

Just how differently automakers treat their suppliers is illustrated by two quotes from the survey about the same manufacturer: “At least you can talk to them” and “Before they were our fairest customer. In the meantime they’re setting the benchmark in the industry for gagging suppliers.”

The issue of whether those involved create a win-win situation with the specific project is important for assessing the business relationship overall from the suppliers’ perspective. Does the supplier provide an innovation, is well rewarded financially in return or is the supplier happy just to gain a foothold with a manufacturer by adopting a lower margin – thereby creating an important reference customer, which can then be monetized in follow-up or external projects?

All those surveyed say about Toyota and Jaguar Land Rover that a win-win situation emerges by and large as part of the contract award process. With Audi, BMW, Mercedes-Benz that always happens in a small proportion of cases, but there are suppliers that experience this only seldom or never in this way with all four manufacturers. Those surveyed believe that Fiat has no interest whatsoever in a contract that would be satisfactory to both parties. Respondents confirm that Opel, PSA, and VW are only or to a large extent concerned with what they stand to gain when awarding the contract.

An important element in this respect is the extent to which manufacturers respect a suitable margin for suppliers whenever they demand price reductions. On average 26 percent of those surveyed confirm that manufacturers always take this into account. In particular, Jaguar Land Rover and Porsche do well in terms of a trustworthy approach to open-book costing, followed by VW, Mercedes-Benz, Audi, and BMW. The large majority of suppliers, however, rate this relationship as by and large trustworthy, highlighting the fact that these suppliers have obviously also had some bad experiences in the past.



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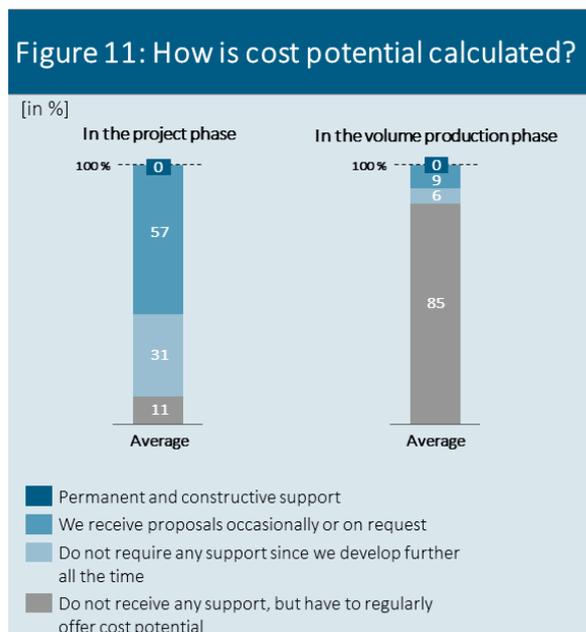
It is obvious that the balance of interests plays an important role for the overall assessment of the relationship between manufacturer and supplier: anyone that feels gagged or has had to slash their margins to secure the contract is by their very nature rather skeptical of the manufacturer.

The suppliers also believe that the single-minded focus on price only brings a short-term cost saving. They see far greater potential in a long-term relationship with the manufacturer in which they can contribute their experience and their expertise. They see themselves as an innovation driver from which manufacturers can benefit – yet this only works in their opinion if the innovations are valued and rewarded – and not just assessed according to the bottom line. If companies integrate suppliers better here and see them more as a partner, they will be able, from the suppliers’ viewpoint, to get more out of joint projects without solely driving down costs.

3.8 Volume-production phase: support when calculating cost potential would be welcomed

Yet in the volume-production phase, if not before, the figures again come front and center – at least that is the way the suppliers see it. Do the manufacturers still provide support in the project phase with calculating the cost potential or do they only make demands on the supplier in the volume-production phase – demands that the supplier then has to implement somehow or other?

On the other hand, the project partners tend to find a common path so they can work together constructively to solve any quality problems that arise. Well over 90 percent of suppliers say that these problems are discussed openly and resolved jointly with manufacturers. The study participants also rate positively the automakers’ acknowledgment of the suppliers’ delivery reliability. Here too, the positive feedback that this is always or at least frequently acknowledged runs to more than 90 percent.



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Other issues, which essentially revolve around the manufacturer's approach, form part of this strong partnership which suppliers aim to cement. How do they react, for instance, in the volume-production phase to fluctuations in volumes: do they try to come up with a solution together or is the responsibility simply pushed onto the supplier's shoulders? Unsurprisingly, this works better with unexpectedly high volumes than if volumes fail to meet the estimates. The extent to which the manufacturer acknowledges quality improvements on the supplier's side is another issue in this area. Here, the approval figures are high as expected.

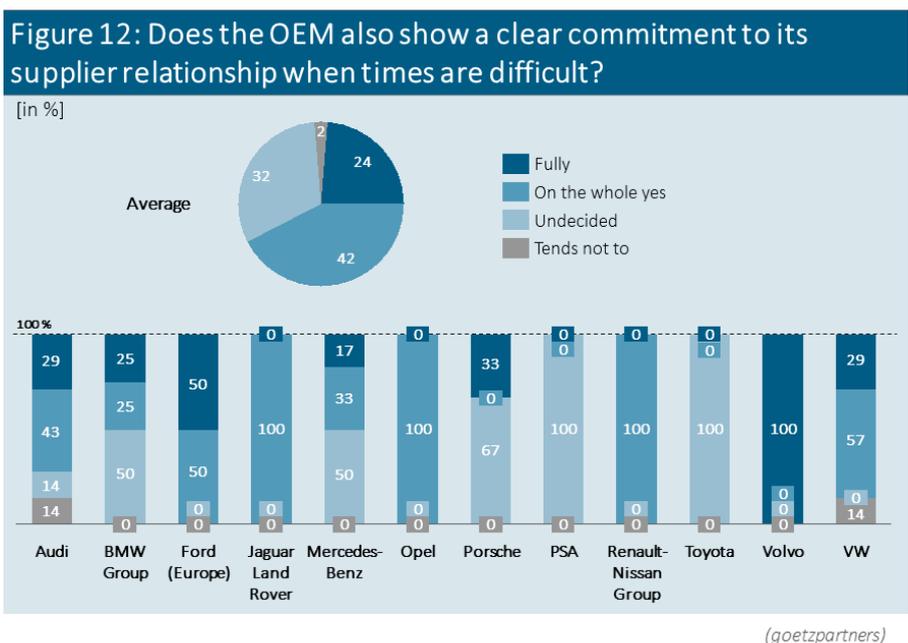
Nonetheless, it needs to be added that many suppliers would like to see more support with calculating cost potential as part of volume production.

3.9 Which manufacturer shows commitment also when times are difficult

How resilient a relationship is – in business as well as in one's personal life – only tends to be seen when the storm clouds gather. If a project closely tracks the best-case scenario – everything is delivered in time, to budget and specified quality, and in the end even the volumes go through the roof – virtually nobody would say that the relationship between manufacturer and supplier is problematic. What, however, if the manufacturer changes the concept, demands renegotiations, or difficulties arise in the operational project work? Here, it is important for suppliers to know they have the manufacturer's backing. Will the manufacturer also support me when things get uncomfortable? Is the manufacturer interested at all in a long-term partnership? Anyone that can answer both questions affirmatively is inherently more satisfied and more inclined to pull out all the stops to work through problems together – and also put in the work beforehand to make this happen.

On average, around 70 percent of those surveyed are convinced that their partners on the manufacturer's side are interested in a long-term supplier relationship. The suppliers are, however, not sure with some automakers what the situation is regarding loyalty and the clear commitment also when times are difficult.

In terms of loyalty, Jaguar Land Rover is the unrivalled leader: all participants confirm absolute loyalty at Jaguar Land Rover. The rating for the rest varies between by and large and always. The picture that emerges for commitment when times are difficult is much more heterogeneous: interestingly the crisis-ridden Swedish company Volvo is committed unconditionally to its suppliers: 100 percent said that is always the case. Ford is also rated very positively, with 50 percent “totally loyal” and 50 percent “predominantly loyal”. Renault-Nissan, Opel, and Jaguar Land Rover were rated 100 percent with the reservation “predominantly loyal”. As regards BMW and Mercedes-Benz, 50 percent of suppliers are not sure; a formidable 14 percent believe that no clear commitment could be expected when times are difficult from Audi and VW.



4 Outlook

The GEAR study allowed us to take an in-depth look at the relationships between the Tier 1 suppliers and the OEMs. The study revealed certain pain points which many market players perceive and which are also known in the market in certain quarters, but which hitherto have not been set out in detail in black and white.

Our aim as a management consultant is to highlight ways out of these perceived and, in certain respects, difficult – given the opposing interests involved – situations. Because the obvious demand placed at the manufacturers' door of abandoning short-term margins in favor of sustainably promoting innovations will be virtually impossible to achieve even if notable pressure to innovate is brought to bear on the premium manufacturers in particular. After all, it will be difficult to permanently justify a premium positioning as well as premium prices and, in turn, corresponding margins without genuine innovations.

And one thing is clear: a German automotive industry, which loses its global reputation as the technology leader, can be in nobody's interest – this industry segment is too important in Germany. In this respect we see the GEAR study as the basis for our work in the automotive and automotive supplier industry since we are going to or indeed have already derived specific alternatives from the findings.

As a platform that promotes dialog between OEMs and suppliers we aim to develop this study into an annual industry trend indicator. In this context, we would be delighted to receive any suggestions regarding the study and would gladly discuss with you constructively the relationship between manufacturers and suppliers in this industry that is so important for Germany.

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As it drafted this study, goetzpartners examined the publicly available information in terms of its plausibility and also assumed that it is accurate and complete, without having this verified by an independent party. Where information regarding the issues covered in this study has been accessed, some of which is no longer up-to-date and/or incomplete, goetzpartners has supplemented this with its own analyses and assumptions.

Our own analyses and assumptions for this study were produced to the best of our knowledge and belief. goetzpartners does not assume any liability for the correctness and completeness of these analyses and assumptions.

By its very nature, this study does not consider the circumstances of any specific individual case. It is therefore no substitute for a specific project undertaken by a professional consultant or detailed research conducted by a third party.