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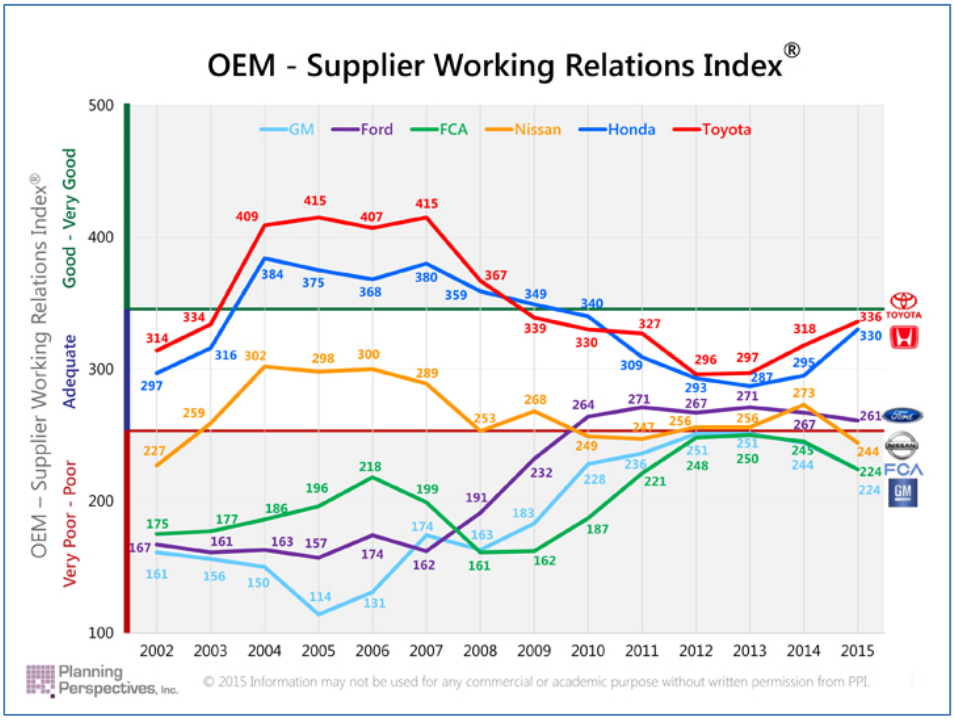
Poor Supplier Relations Costing U.S. Automakers Millions

Detroit, May 18, 2015 – Ford, General Motors, FCA US and Nissan collectively would have earned $2 billion more in operating profit last year had their supplier relations improved as much as Toyota's and Honda's did during the year.

That's one of the significant conclusions from the 15th annual North American Automotive - Tier 1 Supplier Working Relations Index® Study that looks at the automakers' supplier relations and how they impact OEM profits. This year, 435 suppliers participated.

Results of this year's study show Toyota and Honda clearly on top and continuing to distance themselves from Ford, Nissan, FCA and GM who are headed in the opposite direction.



The study is watched carefully in automakers' boardrooms because an OEM's supplier relations rating is highly correlated to the benefits that a supplier chooses to give an OEM – including which OEM is first to see a supplier's newest technology, is provided a supplier's best personnel for support, and gets their best pricing – all of which impacts an OEM's competitiveness and operating profit.

"Last year we unveiled an economic model that proves a direct cause-effect relationship between an automotive OEM's supplier relations and the OEM's operating profit," said the study's author, John W. Henke, Jr., Ph.D., president and CEO of Planning Perspectives, Inc., Birmingham, MI, (www.ppi1.com). "For the first time ever, it allowed us to put a dollar value on suppliers' non-price benefits – those valuable actions and practices, which along with supplier price concessions make a substantial contribution to an OEM's competitiveness. The economic model enables us to determine the economic value of the non-price benefits and the supplier price concessions, which in turn enables us to calculate the supplier total economic contribution to the operating profit of each OEM."

Estimated 2014 operating income (EBIT) increases for GM, FCA, Nissan, and Ford if their supplier relations had improved during 2014 as did Toyota's and Honda's relations.[1]

	Actual 2014 WRI	8.76% Higher WRI than 2014[2]	Estimated Increase in Operating Income per Vehicle	2014 N.A. Manufactured and Wholesaled Vehicles[3]	Total Increase in Operating Income	Percent Increase in Operating Income
GM	244	265	$279	2,685,159	$750,197,626	11.4%
FCA	245	266	$285	2,317,521	$661,311,637	22.8%
Nissan	273	297	$276	947,558	$261,476,915	19.4%
Ford	267	290	$144	2,459,253	$354,327,079	5.1%
				Total	$2,027,313,258	

[1]Toyota's WRI® improved 5.66% during 2014, Honda's improved 11.86% for an average improvement of 8.76%
[2] Indicates projected supplier working relations during 2014 if relations improved like Toyota and Honda average
[3] Ward's Automotive Group, Southfield, MI

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For the past 25 years, Henke and his team have specialized in studying and reporting on buyer and supplier relations in the automotive and 17 other industries. Henke is also a Professor of Marketing at Oakland University, Rochester, MI, and a Research Fellow at the Center for Supply Chain Management at Rutgers University.

"This year, Toyota and Honda improved their WRI ranking a combined average of 8.7 percent over last year's levels. Using our economic model, we know that if supplier relations at Ford, Nissan, FCA and GM also improved by 8.7 percent, they each would have realized significantly higher operating income – an estimated $2.02 billion collectively. At the low end, Nissan would have generated another $261 million and at the high end GM would have earned another $750 million, with Ford and FCA in between."

The 2015 Study also shows the following significant changes in supplier relations among the OEMs:

- Toyota's and Honda's continuing efforts to improve supplier relations have paid off handsomely as they are ranked one and two, respectively, for the fifth straight year, well ahead of the other four automakers. Toyota has been ranked in first place since the study's inception in 2002 except for 2009 and 2010 when Honda captured first place.
- Honda, with 11.8% improvement this year, nearly doubled Toyota's improvement of 5.6%. If Honda keeps up the pace, it could take over first place from Toyota next year. Honda is the most preferred customer of suppliers, but just slightly over Toyota.
- Ford has regained third place over a declining Nissan, but only because Ford declined only 2% compared to Nissan's 10.6%. Ford has dropped to its lowest ranking in five years, but is significantly ahead of FCA and GM.
- In a major shift, Nissan, which was most improved overall last year, had the greatest drop in ratings this year and slipped to fourth place behind Ford. This year, Nissan is the least preferred customer of the six OEMs.
- And, for the second year in a row, FCA's and GM's rankings have fallen. They are now tied for last place, having both dropped 8.5% in the rankings – more than 100 points behind leaders Toyota and Honda.

Why are Toyota and Honda so far ahead?

One word can explain the difference in supplier relations between Toyota and Honda and the other four automakers, said Henke: Commitment. The two top-ranked automakers take supplier relations very seriously and actively work at it throughout their respective organizations, but particularly within their purchasing organizations. This includes the vice president of purchasing down to the buyers who work with the suppliers on a daily basis. They are executing the basics better than the other four automakers. He said that while supplier relations has many complexities, the issues involved are quite straightforward and the resulting OEM benefits are more than worth the effort to improve.

"Over the years, we've seen that certain core or foundational practices have to be in place before an OEM can improve its 'relational activities.' It is the relational activities that help the OEMs improve their WRI score and receive increased supplier benefits that contribute to the OEM's bottom line."

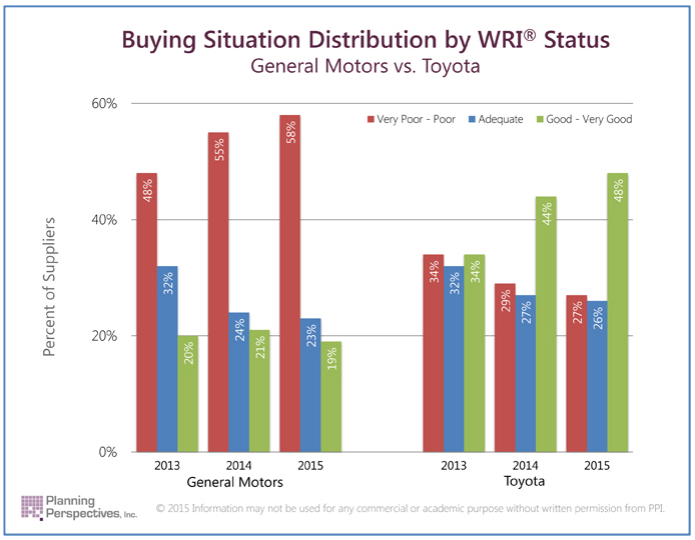
Foundational activities fall into two categories. One relates to the business practices side of the purchasing function, e.g., does the OEM have fair and equitable financial practices, is the supplier treated fairly and as a valued supplier, are contracts honored, is the head of purchasing working to improve relations, is the supplier's intellectual property valued and protected, etc. The other category involves the OEM's buyers themselves: do they have the required knowledge for their job, are they trustworthy, do they work to resolve issues quickly and effectively, are they open and honest when communicating with suppliers, plus about 30 other criteria.

"Once an OEM has the foundational activities in place, then working on improving

the relational activities – which drive the Working Relations Index – will have meaningful impact. These activities involve the nature of the relationship – whether it's adversarial or collaborative – and include the degree of open and honest OEM communication, how much help the OEM provides the supplier to reduce cost and improve quality, how much the OEM hinders the supplier in doing its best job, and finally, the long-term profit opportunities the supplier perceives are available from working with the OEM.

"Toyota and Honda are executing the foundational activities very well and continue working to improve them while they also focus on improving their relational activities. That's why we see the growing gap between them and Ford, Nissan, GM and FCA, each of whom is struggling with the foundational activities."

It is also why the percentage of suppliers who say they have poor relations is increasing with GM and FCA and is now at a three-year high for both OEMs, 58% and 54%, respectively, and conversely, why the percentage of suppliers who say they have good relations with Toyota and Honda is at a three-year high. (See graph to right, red bars "poor relations" vs. green bars "good" relations.)



Over the years, the study has shown convincingly that automakers should be working work very hard to improve their relations with suppliers – especially since the OEMs spend 60% - 70% of their revenue with suppliers and because suppliers play an increasing role in the success of vehicle programs through their sharing of new innovations with the OEMs.

The study shows that suppliers with good working relations with an OEM provide their customer considerable benefits. These suppliers:

- Are more willing to invest in new technology to meet future OEM needs, and are more willing to share new technology with the OEM
- Are more willing to support the automaker beyond contractual terms
- Communicate more openly and honestly with the OEM
- And importantly, give greater price concessions to the OEM

Whereas, automakers with poor relations:

- Receive smaller price concessions and must work harder to get them
- Get less experienced supplier personnel supporting them

- And typically are not among the first to get the suppliers' best ideas and new technology

Detailed Summary: 2015 vs 2014

- **Toyota and Honda:** Toyota's WRI improved by 5.6% to 336 -- its highest level in five years, and maintains first place, just above Honda at 330. However, Honda had the greatest improvement of the six OEMs at 11.8 percent. Both companies' VPs of Purchasing and their buyers are the highest rated in building trusting relations. Both companies dominated and split the top rankings in Purchasing Area WRIs, with each taking three of the six. Both are rewarding high-performing suppliers with new or additional business more so than other OEMs. Not surprisingly, Toyota and Honda are suppliers' most preferred customers.

- **Ford and Nissan**: While Ford continues to tread water, having a second straight year of slightly declining relations, Nissan's ranking has dropped significantly. Ford improved slightly in communication with suppliers and is a significantly more preferred customer than GM, FCA, and Nissan. However, the number of suppliers with good relations with Ford has dropped for the third straight year to a low of 24%. While Ford's Purchasing VP is tied for last place with FCA's in building trusting relations, Ford's buyers are ranked third overall. Nissan has become the least desirable OEM to work with. Nissan buyers have become quite adversarial in seeking price reductions, and the number of suppliers who say the threat of losing the business if they didn't comply rose to 29 percent from 17 percent. Nissan suppliers have also experienced a significant decrease in being able to recover material cost increases, in being treated fairly, and in having contracts and commitments honored.

- **GM and FCA:** Supplier trust of GM buyers is at its lowest in three years, and is the lowest of the six OEMs. However, GM's Purchasing VP is ranked third behind Toyota's and Honda's in building trusting supplier relations. Pressure on GM suppliers to reduce cost, improve quality and introduce more innovation has increased significantly, with GM buyers becoming more adversarial in going after supplier price reductions. The threat of losing business has increased to 27 percent from 18 percent as the most important reason suppliers give for giving a price concession. At FCA, all business practices that build good supplier relations continue to decrease. FCA's Purchasing VP is tied with Ford's VP in last place for building trusting relations, while FCA's buyers are dead last in virtually all measured areas. On-time payments and payment issues resolution at FCA remain lowest among the six OEMs. Communication has improved slightly, but FCA help to reduce cost/improve quality has decreased, while hindrance and opportunity to make a profit have increased. Not surprisingly for GM and FCA, the percent of buying situations with poor relations are at a three-year high for both companies and exceed 50 percent – FCA at 54 percent and GM at 58 percent, the highest among the six OEMs. GM and FCA are the least preferred OEMs with whom supplier prefer to do business.

"Toyota and Honda clearly understand the value of strong supplier relations and their management teams support the effort to achieve them. They're heading in the right direction, but the question remains: Can they get back to elevated levels they achieved in the 2004-2007 period? It certainly appears that's what they're working toward," said Henke.

So What's not Working for the Detroit 3 and Nissan?

The question also remains, what's wrong with GM, Ford, FCA and Nissan? Henke thinks there are three potential factors involved. First, their supplier relations programs are not focused on a sufficient number of the foundational or relational activities that can make a difference in supplier relations. Second, the buyers and engineers responsible for implementing the necessary improvements are simply not capable of doing so, or more likely are not sufficiently motivated do so. And third, when internal mandates come down to reduce cost, buyers are simply reverting back to their old adversarial ways of getting the reductions, because for them building collaborative supplier relations is of little importance.

"OEM buyers and management have to remember that cost reductions, contract changes, and other similar programs do not of themselves result in poor supplier relations; it's the manner in which these programs are administered that causes poor relations with suppliers," said Henke.

The German North American OEMs

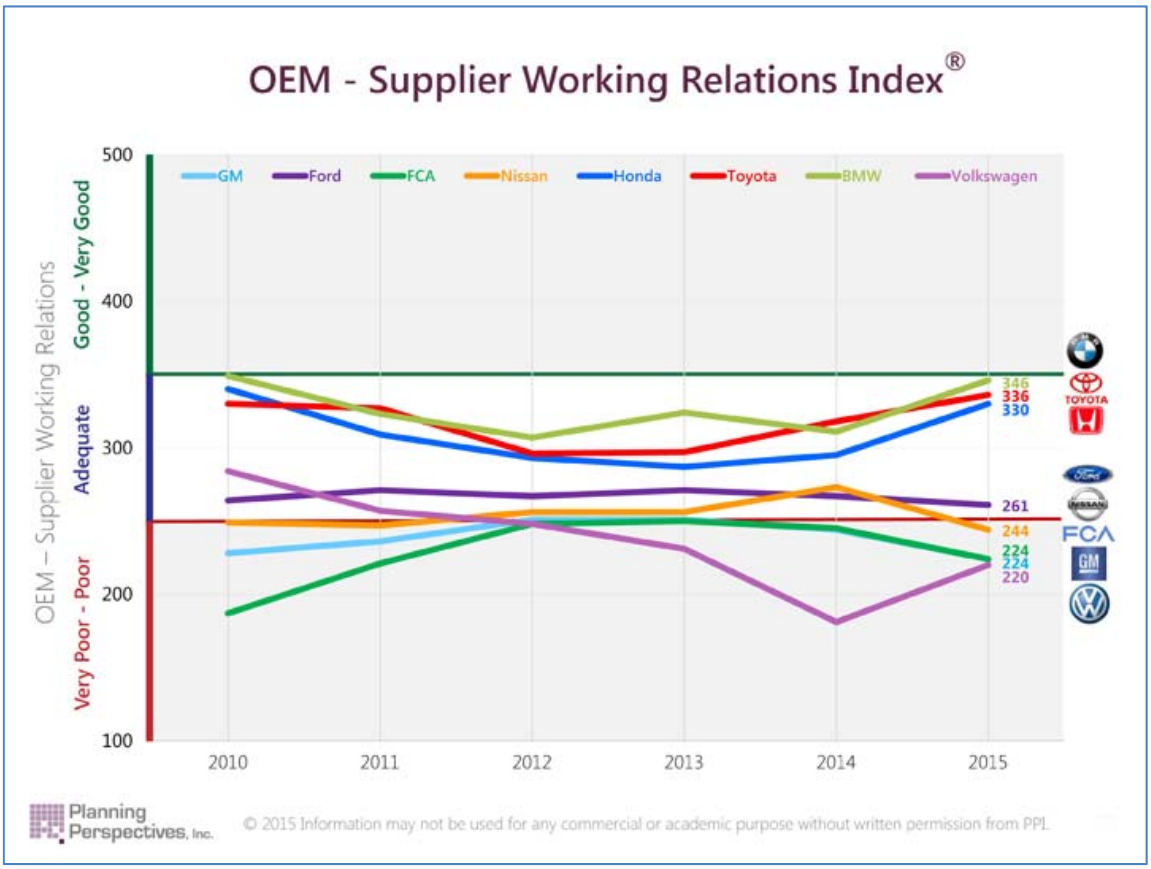
In 2010, Planning Perspectives began studying the German automakers with manufacturing operations in North America: BMW, Mercedes-Benz, and Volkswagen. This year sufficient responses were received to report on BMW and VW.

BMW's supplier relations improved this year (WRI® = 346 vs. 311) and now leads Toyota in the overall supplier relations ranking of the automotive manufacturers (see chart below). Volkswagen's supplier relations improved (WRI® = 220 vs. 181), but continues to lag all OEMs in the supplier relations rankings. The WRI® rankings for the two Volkswagen operations -- VW-Puebla and VW-Chattanooga -- are 205 and 240, improving from 187 and 177, respectively.

The increase at BMW resulted from increases across the WRI® Hindrance, Communication, and Supplier Profit Opportunity components, which were offset by a drop in the Help Component. The VW WRI® increase occurred because of slight improvements in all five WRI® components: Help, Communication, Hindrance, Relationship, and Profit Opportunity.

If VW relations had improved four additional points to the level of FCA and GM (WRI® = 224), it is estimated that VW's North America operations would have realized an additional $19.9M in operating profit (EBIT).

If the Japanese 3, the Detroit 3 and German 2 were combined on a consolidated WRI® graph as below, BMW would rank highest of the nine automakers and VW the lowest.



About The Study: Now in its 15th year, the Annual North American Automotive OEM-Tier 1 Supplier Working Relations Index® Study tracks supplier perceptions of working relations with their automaker customers in which they rate the US and Japanese automakers across the six major purchasing areas broken down into 14 commodity areas. The results of the study are used to calculate the WRI® which is then used to calculate the economic value of work relations based on a proprietary PPI-developed economic model. This year, 541 sales persons from 435 Tier 1 suppliers – representing 1,595 buying situations (e.g., supplying brake systems to FCA, tires to Toyota, seats to GM) and 59% of the six OEMs' annual buy – responded to the survey. Demographically, the supplier-respondents represent 44 of the Top 50 NA suppliers and 67 of the Top 100 NA suppliers.

About PPI: Since 1990, PPI has specialized in developing and implementing supplier surveys for the automotive OEMs and Tier 1 suppliers, and companies in 17 other service and manufacturing industries worldwide, including the airframe, aircraft engine, computer, construction tool, electronics, energy, and food industries. In 2001, PPI initiated its syndicated annual North American Automotive OEM - Supplier Working Relations Index® Study of the Big Six US and Japanese automakers and in 2010 began tracking the US-based German automakers as well. In 2011, PPI added a financial-impact study that quantified in terms of lost profits what poor relations were costing the lower rated automakers. The annual WRI® Index study has been recognized as the benchmark of supplier working relations for the automotive industry and in numerous academic research articles including the *Harvard Business Review* and several books.

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