

Diversification trends in the automotive supplier sector

Time for auto suppliers to leverage their capabilities in adjacent industries?



Automotive suppliers once resided in a fairly stable business environment with reliable demand. The growing number of passenger cars sold in Europe each year has led to a similarly increasing demand for OEM components and parts. Moreover, the overall vehicle fleet on Europe’s roads has continuously grown, allowing for a healthy aftermarket for spare parts. In recent years, however, fundamental technology trends like the accelerating shift toward new powertrain technologies – electric vehicles – or the ascent of connected technologies have disrupted traditional supply chain relationships. Many auto suppliers are faced with eroding revenue pools in their traditional core business and must find ways to compensate. The pressure to tap into new sources of business has further increased during the global pandemic and, consequently, the auto market downturn. Indeed, an analysis of acquisitions by automotive suppliers in the last 10 years shows considerable momentum in the M&A market with multiple suppliers venturing into new business and technology domains adjacent to their traditional core business. While less than half (47%) of acquisitions by auto suppliers in 2011 involved a target company outside the automotive sector, this share has climbed to 65% in 2020. In a recent Arthur D. Little survey of more than 50 senior executives in the automotive supplier sector in the DACH region (Germany, Austria, and Switzerland), we set out to investigate the market’s perception of diversification trends to understand its growth trajectory and future implications. We asked survey participants about their perspectives on diversification trends as well as their company’s past, current, and future diversification activities.

Background and survey methodology

Based on a series of analyses of M&A activities and discussions with supplier executives, we formed the following hypothesis of an accelerated diversification trend among automotive suppliers:

“Diversification” in the context of our survey is understood as tapping into new growth opportunities in **adjacent business areas outside the automotive sector**.

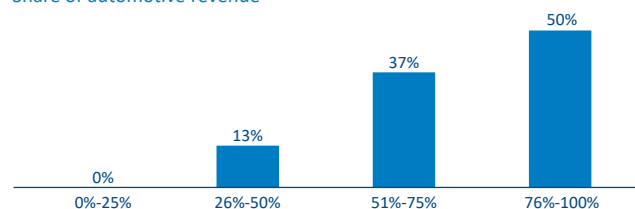
To capture the “voice of the market” and explore the sector’s status quo and future plans, we conducted an expert survey with more than 50 senior executives in the DACH region. The survey panel consisted of executives from major automotive suppliers (>100 million EUR automotive business) as well as financial investors with a focus on investments in the automotive supplier sector.

Status quo and trend buildup

To more fully understand the current situation, we asked participating executives about their companies’ current revenue share of their automotive core business. The responses indicate that auto suppliers are still only moderately diversified at this point in time (see figure below).

50% of surveyed companies currently generate the vast majority (75%-100%) of their total revenue with their automotive core business.

Share of automotive revenue



Source: Arthur D. Little survey

However, almost half of surveyed companies have already ventured into non-automotive terrain in the past five years, implying a significant momentum buildup in the recent past.

49% of surveyed suppliers have diversified into non-automotive industries in the last five years, while suppliers as part of a financial investor’s portfolio show an even higher share.

Furthermore, the general perception of executives points toward an accelerated diversification trend among auto suppliers.

64% of respondents agree or partially agree that diversification of automotive suppliers into non-auto business has increased in recent years.

Looking ahead, there seems to be strong consensus that this trend will accelerate in the next few years.

95% of respondents who recognize an increase in diversification activity in the recent past expect a further acceleration of this trend in the coming years.

Even executives who have not recognized an increased diversification activity in recent years expect this trend to emerge in the future.

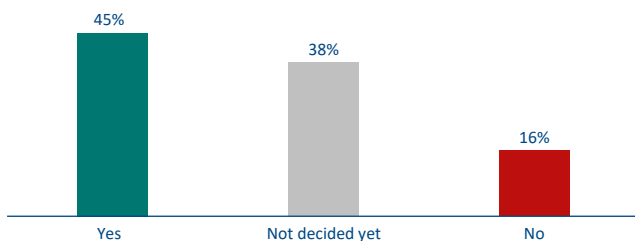
75% of respondents who do not recognize an increase in diversification activity in the recent past expect such a trend to emerge in the coming years.

Diversification plans for the future

Almost half of surveyed suppliers already have strategic plans to diversify into new business domains (see figure below).

45% of responding companies plan to diversify into new non-automotive areas in the next five years – only 16% have no diversification plans.

Diversification plans



Source: Arthur D. Little survey

The survey also reveals a considerable share of companies “sitting on the fence” – they have not yet made clear plans for the near future.

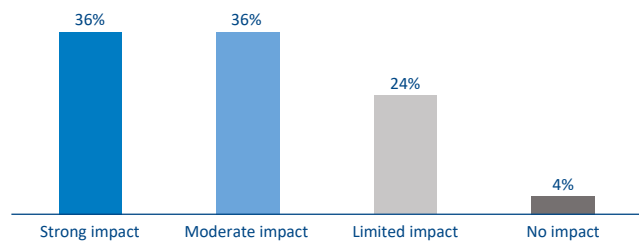
38% of respondents report that their company has not yet decided whether they want to diversify.

COVID-19 as trend accelerator

In the wake of the global pandemic, many suppliers have been hit hard by their strategy to bet on the automotive industry as their single winning horse. It is not a surprise, therefore, that the majority of surveyed executives believe that COVID-19 will considerably accelerate the diversification trend (see figure below).

72% of surveyed supplier executives believe that COVID-19 has a moderate or strong impact on diversification trends – only 24% expect a limited impact.

COVID-19 impact



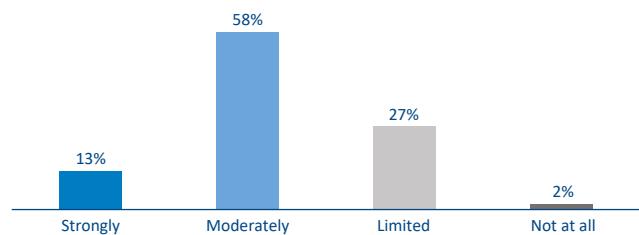
Source: Arthur D. Little survey

Widespread impact and decreasing automotive share

Another important finding is that the diversification trend is not limited to a few selected supplier technology domains. Our survey panel – with its balanced representation of all main technology domains – confirms that diversification is expected to affect almost all of them (see figure below).

98% of respondents expect their company to be generally affected by the diversification trend; 71% expect a strong or moderate impact on their company.

Diversification trend impact



Source: Arthur D. Little survey

While diversification in the automotive supplier industry is expected to be a widespread phenomenon impacting the majority of technology domains, powertrain and electronics suppliers are likely to be affected most.

Measuring the level of diversification as the share of automotive business revenue compared to the total revenue of the company, the survey results imply a significant change of revenue structures for many automotive suppliers in the future.

51% of surveyed automotive suppliers expect the revenue share of their automotive business to decrease over the next five years.

Even executives who do not recognize increased diversification activity in recent years, expect this trend to emerge in the near future.

Growth through acquisitions preferred

When asked about the most likely way they would diversify into non-automotive business areas, the majority of surveyed companies said that they prefer inorganic growth to quickly acquire the required capabilities and market access.

76% of surveyed companies plan to exclusively or predominantly diversify through inorganic/M&A strategies.

Prepare your diversification move

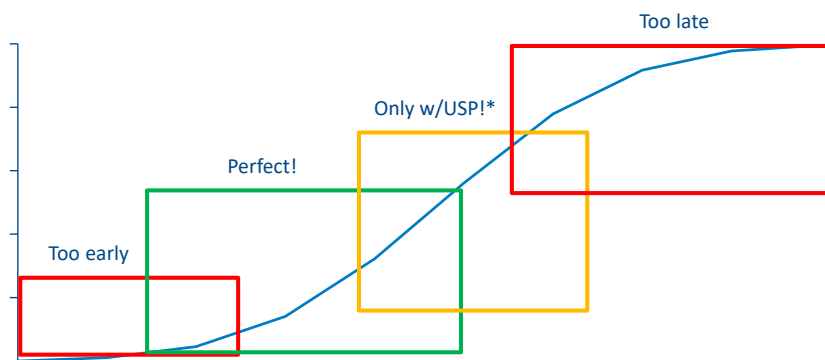
Driven by fundamental technology shifts and the convergence of industries, the automotive supplier sector has changed from a fairly stable environment into a more dynamic landscape with lots of revenue pools at stake.

To avoid a potential downward spiral resulting from putting “all their eggs in one basket,” auto suppliers should investigate the opportunity to diversify into other markets. Diversifying into new sectors is a challenging, risky endeavor and requires a sound strategy to be successful. Automotive suppliers intending to diversify should follow these general rules:

1. Assess competences and strengths

Many suppliers have excellent capabilities that have been developed over decades in the highly demanding automotive industry. From engineering and large-scale production to material competences, surface treatment, and so forth, these capabilities will likely meet demand in other sectors. As a first step, it is crucial to conduct a realistic (self-)assessment of existing competences to identify any cutting-edge capabilities that can be transferred to other domains.

S-curve model



Source: Arthur D. Little analysis
*Unique selling proposition

2. Identify and prioritize opportunities

Second, suppliers need to identify and prioritize promising target sectors where the company’s strengths can be leveraged. To avoid getting overwhelmed with the panoply of opportunities, this selection needs to be a structured process guided by distinct strategic principles, a realistic feasibility assessment, and clear prioritization criteria. Also, a first high-level quantification of business potential should be implemented at this stage.

3. Finding the right spot on the S-curve

When seeking diversification opportunities in adjacent businesses, timing is key. Suppliers need to gain a good understanding of which stage of the industry lifecycle potential target areas fall under. Entering into new businesses still in an early stage of the S-curve can be overly risky, whereas entering into domains in a late stage of the S-curve may no longer offer the growth opportunities that would justify such a major strategic move. Hence, finding diversification areas on the right spot of the S-curve is crucial (see figure below).

4. Understand resource requirements and define diversification mode

Finally, suppliers need to develop a clear perspective on the financial and nonfinancial resource requirements to successfully implement their diversification strategy. This typically goes along with a decision on organic or inorganic (e.g., M&A) diversification. Both modes of diversification need to be evaluated in light of the resources required to execute the strategy and the experience a company has with either of them. Moreover, the impact the resource requirements have on the core business needs to be considered for a holistic decision.

5. Consider external expertise

Finally, successful diversification of automotive suppliers into non-automotive areas requires broad-scale market and technology expertise, deep insights into converging industries, and a good understanding of the do’s and don’ts of adjacent growth strategies.

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Arthur D. Little

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