



## Embracing the evolving nature of innovation

### Deloitte Commentary: Q3 2024 MEMA OE Automotive Supplier Barometer

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When innovation is discussed, the conversation is often focused on the vehicle even though the automotive sector has led in manufacturing and supply chain innovation since the outset of our industry. If you have attended CES or MOVE America, you might have found that innovation has become synonymous with connected, electrified vehicles.

However, product strategies and timelines are often being whipsawed by industry stakeholders as they attempt to juggle a wide variety of imperatives. These can include a need to produce affordable vehicles while maximizing profitability, creating and maintaining manufacturing jobs, ensuring supply chain resilience in the face of geopolitical conflict, and decarbonizing the planet. It's no wonder some people may seem anxious about the path forward for the automotive sector.

For their part, suppliers are increasingly concerned about the risk of slowing sales among the vehicle programs to which they are attached. It represents the top risk to the industry over the coming 12 months according to results from the most recent [MEMA OE Vehicle Supplier Barometer Study](#), eclipsing concern over potential weakness in the U.S. economy. However, vehicle inventories continue to rise,<sup>1</sup> along with the incentives<sup>2</sup> designed to help keep an increasingly cost-conscious consumer engaged in the new vehicle retail market.<sup>3</sup>

Underlining the impact of market uncertainty, nearly three quarters (72%) of MEMA members report having at least a moderate amount of volatility in their capacity utilization rate over the past year, while 40% are currently experiencing a deterioration in their utilization.

In response, many suppliers surveyed are attempting to address these utilization concerns by implementing time-tested strategies, including flexible manufacturing and diversification into non-automotive sectors.

### **Changing the definition of innovation**

Over a third of suppliers (36%) responding to the MEMA survey believe they are ahead of their peer group when it comes to the pace of innovation in their products and manufacturing processes, but the nature of innovation itself may also be changing around them. Innovation is evolving to encompass more than ever before, requiring companies to embrace emerging tools like artificial intelligence (AI). Only 18% of MEMA members feel they are lagging behind, with half of Barometer survey respondents feeling their performance is on par with their competitors. Some outperforming suppliers surveyed attribute their competitive advantage to a focus on automation, talent programs, and joint ventures to access leading technologies. All of which have been important to business transformation strategies for many years.

In fact, 3 in 4 suppliers surveyed believe automation and robotics represent a moderate/significant opportunity for innovation, followed by the application of advanced materials/processes (62%), electrification (53%), and AI (51%). Only a third of suppliers pointed to software-defined vehicles (SDVs) as a source for innovation. This is despite the tectonic shift SDVs represent for the automotive value chain over the coming decade.<sup>4</sup>

Even though AI was highlighted as a source of innovation, over half of suppliers surveyed said they do not have a formal policy in place related to its application across their business. However, just over a third of MEMA members responding to the survey said the establishment of a formal policy was in progress, but less than 1 in 5 responding suppliers said their company's IT infrastructure was prepared to take advantage of

AI integration. A further 24% of suppliers feel they are either somewhat or completely unprepared, raising questions about whether they will be able to keep up with the torrid pace of AI implementation. A rapidly increasing number of companies are looking to generate significant cost efficiencies and quality improvements using AI tools.<sup>5</sup>

### **Capital needs increasing for M&A**

More than half of suppliers (57%) responding to the MEMA survey expect their capital needs for merger and acquisition (M&A) opportunities to increase somewhat/significantly in the next fiscal year. Moreover, 65% of suppliers are confident they will be able to access the capital required to fund their M&A aspirations. Overall, 4 in 10 suppliers surveyed expect 75% or more of their capital needs will be funded via free cash flow in 2025. A third of surveyed suppliers also expect some relief on their commercial loan interest rates over the next 12 months.

Many suppliers may be looking to M&A opportunities to kickstart their innovation efforts and/or acquire new technologies and skilled talent. However, they should look to invest the time and resources required to comprehensively prepare their business prior to an acquisition. In some cases, critical aspects of a post-acquisition integration (e.g., IT infrastructure) can be overlooked, requiring costly mitigation initiatives, potentially compromising the original objectives of the deal.

Auto suppliers have seen their fair share of existential threats, and many are likely capable of navigating the challenges ahead. However, some may be looking back to yesterday's answers which may not be equal to the task of tackling tomorrow's problems. Getting beyond studies, committees, and pilot programs to see the transformative impact that technologies like SDVs and AI are starting to have in the auto sector will be important moving forward.<sup>6</sup>

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## Endnotes

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<sup>1</sup> Erin Keating, [New vehicle inventory increases as 2025 model years begin to arrive; automakers take notice](#), Cox Automotive, June 13, 2024.

<sup>2</sup> [New vehicle sales incentives climb higher in July, according to Kelley Blue Book estimates](#), Cox Automotive, August 13, 2024.

<sup>3</sup> Giulia Carbonaro, [Americans can no longer afford their cars](#), Newsweek, January 15, 2024.

<sup>4</sup> Chris Ahn, [How software-centric systems can accelerate electric vehicle adoption and automotive paradigms](#), Automotive News, August 19, 2024.

<sup>5</sup> Austin Weber, [The growing role of AI in automotive assembly](#), Assembly, January 30, 2024.

<sup>6</sup> Rick Whitford, [Overcoming legacy data constraints to unlock the potential of generative AI](#), Automotive News, August 13, 2024.

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