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UNITED WE STAND,
DIVIDED WE FALL:
SUPPLY CHAIN
CONSOLIDATION AND
THE RISE OF RISK-
SHARING PARTNERS
IN THE AEROSPACE &
DEFENSE INDUSTRY



The pressure for change

Boeing delivered an industry record of 723 jetliners in 2014¹, and with Airbus also ramping up its production line², order levels across the industry are healthier than they have ever been before. The consumer expectation of low fares, however, is putting pressure on airlines to procure new planes at much cheaper costs; demands that are then passed down from the OEM through the supply chain to maintain profit margins. On top of these pressures from airlines, OEMs and tier ones have in recent years had to bear the brunt of the financial investment risk, a burden that further challenges operating profits and the bottom line.

As a result of the squeeze, manufacturers are seeing a big rise³ in both the number and value of Mergers and Acquisitions as companies continually look to combine forces in the face of these budget cuts from OEMs. Consolidation like this is a natural progression. For example, a large midsize supplier has the ability to tap into newer markets for previously inaccessible revenue opportunities. This greater size also permits further streamlining and fine-tuning of internal operations, and provides greater stability to bear the brunt of this top-down pressure.

The roll out of Boeing's Partnering for Success programme is just one example of OEMs and tier 1s moving towards this strategy of encouraging efficiency in the supply-base. At its core, this particular programme aimed to reduce base supply chain costs by at least 15%⁴. If this is going to continue to be a major trend across the industry, how can the aerospace supply chain survive under the weight of this huge financial pressure?

The automotive influence

This level of consolidation is certainly a significant, even transformational shift in the aerospace supply chain. But this isn't an entirely new concept. In fact aerospace is simply rolling out a template that has been used for more than 30 years on the roads and in the factories of the automotive industry. As with its automotive counterpart, the

dynamic of the new aerospace industry is driven by aggressive cost reductions and price squeezing at the supply base.

This pressure to deliver improved quality, increased production, and enhanced service – all at lower prices, has been tough on both industries. But, there is light at the end of the tunnel. Despite the initial hardship, automotive supply chains saw huge improvements in supplier performance, quality, and in the elimination of waste - all to the tune of billions in savings for the manufacturers. The aerospace industry's efforts to reduce supply costs are analogous to the drastic changes to the automotive supply-chain in recent decades.

So how can the aerospace industry learn from automotive? How can OEMs, tier 1s and suppliers all work together to respond to these pressures and actually harness profit for all? One option available that has had huge amounts of success across the board is the fostering of a culture of cost-sharing, reducing overall supply costs for the OEM, distributing profits across suppliers and driving innovation and knowledge sharing.

Sharing the load

Increased market competition has necessitated proactive responses to adopting leaner practices. A key element of this has been the development of open dependencies between business partners - long-term risk-sharing relationships that reduce costs and ensure high quality.

The initial upfront investment for manufacturers is huge and with five- to seven-year life cycles the norm, significant returns can take a long time to come to fruition, potentially leaving OEMs and tier 1s financially vulnerable. The research and development costs of a recent Rolls-Royce engine, for example, stood at around \$1 billion⁵ and took five years to develop. By forging risk-sharing partnerships, OEMs and tier 1s can share the burden of this expense, but equally, the suppliers can benefit from a percentage cut of the proceeds.

But it's more than just financial. Previously, relationships in the supply chain were purely transactional. But risk-sharing partnerships, by their very nature of co-dependency, forge long-term connections that align the suppliers and manufacturers with a common goal. Quite simply, the initial upfront investment focuses both on achieving the same objective, and aligning these goals allows suppliers more freedom, favouring the integration of cultures and skills.

Risk-sharing partnerships go beyond a simple transfer of technology or fulfilling contractual obligations. The open and transparent relationships encourage the sharing of ideas, combining knowledge to drive innovation and exceed expectations. With united effort, capabilities and capacities are expanded, and it all stems from the collective investment that underlies risk-sharing.

Adopt, adapt and improve

As we've seen in the automotive industry, supply chain consolidation is a natural progression following huge financial pressure from the top down. OEMs and tier 1s have to demand more of their suppliers and the resulting rise in M&A activity is driven from their need to consolidate resources and squeeze extra revenue. But there are ways, methods and by-products that are being used across the industry to actually turn this pressure into profit.

The collective approach to airplane technology transformation - risk-sharing partnerships - spreads the risk and burden of upfront investment across the entire ecosystem, but equally, distributes the profits and rewards. Taking the ethos further, risk-sharing partnerships have an even greater secondary benefit, as the combination of financial strength and expertise held by each partner, united by their common objective, actually facilitates exploration and furthers technology innovation.

References

- ¹ <http://www.cnbc.com/id/102316212>
- ² <http://www.ft.com/cms/s/0/e73bca0c-be52-11e4-8036-00144feab7de.html#axzz3YcQG2Tft>
- ³ http://www.pwc.com/en_US/us/industrial-products/publications/assets/pwc-aerospace-defense-industry-mergers-acquisitions-q4-2014.pdf
- ⁴ <http://www.onlineamd.com/amd1114-aerospace-supplier-accomodations.aspx>
- ⁵ http://www.rrnetc.co.uk/pdfs/partnerships_tcm92-11186.pdf

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