



Seating can contribute much to the appeal of any car, Lear Corporation argues.

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Extra complexity after Lear makes its move

Relationships in the automotive supply chain have always been interesting, not least for tanners, who usually sell to original equipment manufacturers (OEMs) but supply finished leather or cut parts to specialist tier-one suppliers of seats, steering wheels and other car interior components. In 2014, one of these specialist tier-ones, Lear Corporation, added extra complexity and extra tension to this panorama by acquiring a major, global automotive tanning group, Eagle Ottawa. This article examines Lear's reasons for taking this step and offers a view of the likely reaction among other tanners and tier-ones, and among OEMs in the months and years following the deal.

Lear Corporation, one of the select group of tier-one seating suppliers that have the capacity to serve the whole of the global automotive industry, confirmed in August 2014 that it had bid successfully to buy automotive tanning group Eagle Ottawa.

To explain why this move is unusual and has provoked a widespread reaction in the automotive leather industry, it's necessary to attempt to describe some of the dynamics of the relationships automotive tanners have to establish and maintain. Automotive leather is becoming increasingly popular, with a recent study suggesting that, if the automotive segment consumes a share of between 15% and 18% of the total number of cattle hides being processed around the world today, this is expected to rise to a share of at least 25% by 2020.

Car companies, the original equipment manufacturers (OEMs), clearly want more leather and their typical way of sourcing it has been to hold direct discussions with tanners, agreeing volumes, quality ranges and prices, and then placing orders. However, tanners' instructions, more often than not, are to ship the finished leather not to the OEMs directly, but to tier-

ones which supply seating systems as direct components. OEMs have little interest in watching while the leather upholstery goes onto seats, steering wheels, door panels or other parts of the car interior and no interest at all in carrying out this work themselves. At the time of final assembly, it's the whole product, frame and cover, that they want on their production lines, in the right place at just the right time. It's the tanners' responsibility to ship their finished leather to the tier-ones and the tier-ones' responsibility to fit the leather to their products and ship the complete component directly to the OEM.

Extra services

Tanners want to process hides and focus all their efforts on making the finest quality finished leather they can. In recent years, they have increasingly been asked by OEMs to perform cutting or cut-and-sew operations too. The reasons for this are complicated. On the surface, OEMs say they want the tanners to take more responsibility for cutting because it's they, the tanners, who know leather inside out. Tier-ones also carry out extensive cutting operations and would like OEMs to put more



The Volkswagen Passat wins European Car of the Year at the 2015 Geneva Motor Show. Volkswagen is one of the OEMs Lear Corporation wants its acquisition of Eagle Ottawa to open doors to.

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of this work their way, while tanners often seem to view it as an extra service they have to offer if they want to keep selling their leather to the OEMs. For this reason, when tanners hand over their leather to tier-ones, the tier-ones are far from shy about complaining to the OEMs, expressing concerns about quality, cutting accuracy, on-time delivery and any other objections they can raise (with the subtext very often being that the OEMs ought to see sense, take this part of the process away from tanners and hand it over to them, to the tier-ones, instead). When it comes to cutting, tanners are their rivals. There is anecdotal evidence of the OEMs becoming tired of having to intervene in disputes of this kind between tier-ones and tanners over quality and delivery issues.

There are some indications in the automotive leather supply chain that, contrary to what the tier-ones have been pushing for, the OEMs have asked tanners to carry out more cutting rather than less precisely because of concerns that some of the big tier-ones may have become too powerful. To stop this power from going to the tier-ones' heads, the OEMs have placed a larger part of their business with tanners instead. Few things in this environment have a quick turnaround: tier-ones talk of quoting today for seating programmes that will go into production three years from now and then run for a further five years. There will always be tensions, but there also has to be confidence that your supply chain partners are serious people who are in it for the long haul. Lear Corporation's decision last year to reach further upstream in the supply chain and acquire Eagle Ottawa has meant the tensions in the three-way relationships described above are likely only to increase.

Growing popularity

Soon after the company announced that previous Eagle Ottawa owner, Wisconsin-based private investment firm Everett Smith Group, had accepted a bid for the tanning

group, Lear chief executive, Matt Simoncini, told analysts from Morgan Stanley that his company has a keen interest in the way car seat designs are integrating leather and fabric together. Lear, which also has a growing automotive electronics division, had already bought, in 2012, a North Carolina-based supplier of fabric for automotive interiors, Guildford Mills. Mr Simoncini said, too, that the growing popularity of leather among automotive companies and consumers was also an important factor.

Matt Simoncini describes leather as a sub-segment of the auto industry that is growing faster than others. Avoiding becoming carried away, he says leather's share of all the surface material that goes into cars worldwide is likely to remain at a rate of 4% or 5%, but because of the growth in the industry overall, described above, OEMs, collectively, are certain to consume more leather in the years ahead. His position is that his company's move for Eagle Ottawa, for which the two parties agreed a valuation of \$850 million, was "a great acquisition at a right and fair price". The deal closed at the start of 2015.

Positive impression on consumers

In Mr Simoncini's opinion, only Lear and one rival, Johnson Controls International, can supply complete seating systems in all the major car-producing locations around the globe, which matters in a world in which OEMs' production networks are becoming increasingly spread out. Seating can contribute much to the appeal of any car, he argues, influencing fuel economy, safety, comfort and craftsmanship. Consumer demand for craftsmanship is going up and OEMs are looking for suppliers that can help them make a positive impression on the buying public, Mr Simoncini insists.

It's in an attempt to equip itself better to be such a supplier that Lear Corporation has acquired Eagle Ottawa, already a producer of leather for "virtually every major automaker", the Lear chief



Hungarian government minister András Tállai (right) visits Eagle Ottawa's finishing and cutting plant at Szolnok in July 2014, just before the automotive tanning group was acquired by Lear Corporation. This plant, in central Hungary, will help Lear Corporation cement its reputation as one of the few companies that can supply complete seating systems in all the major car-producing locations around the globe.

CREDIT: HUNGARIAN MINISTRY FOR NATIONAL ECONOMY

executive continues. For example, this deal will immediately increase Lear's business with Honda and Toyota, he explains. At the same time, being owned by Lear will give Eagle Ottawa an opportunity to supply its leather to OEMs that it has not been able to do business with before, with Fiat, Volkswagen and Audi as examples; all of these car companies are looking for "alternative sources of leather", according to Mr Simoncini. This is a vitally important point and one that we shall return to. "This is a business that we are buying to build on," he says. "It's not a complete absorption; we want to keep some level of independence [of Eagle Ottawa]. That's the feedback we're getting from the customers. The customers are hugely supportive of the acquisition because they realise that designs are becoming a combination of leather and fabric, not just leather or fabric, and they believe there are synergies when you couple it with Lear's knowledge of how to design and build a seat."

He speaks in praise of the Eagle Ottawa management team, too, and says they are "real car folks". In time, the design teams of the two groups will begin working together as well, offering further synergies to OEMs.

Three-way relationships

All fine in theory, but if Eagle Ottawa continues to supply leather to other seating system suppliers, and in parallel if Lear Corporation continues to source leather from other automotive tanning groups, there will be consequences for the three-way supply chain relationships in automotive leather as indicated. With Eagle Ottawa now part of Lear Corporation, Eagle Ottawa may be perceived as having a role to play in the way Lear maintains its relationships with other automotive tanning groups, groups which may be reluctant to give Lear too much insight into their pricing structures, production programmes and ways of working out of fear of the information coming into the hands of and helping a direct rival, Eagle Ottawa. At the same time, Lear's traditional rivals in the seating sector may be unhappy about sourcing leather from, working closely and sharing production



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data with Eagle Ottawa if they perceive that this information may give Lear Corporation an advantage over them.

Ray Scott, who is president of Lear Corporation's global seating business, says he believes his company's customers and the supply chain partners it works with to serve them are unlikely to have cause for concern. The benefits that high-quality seating can bring to a car are becoming increasingly clear to OEMs and to end consumers, he says, and the trend of OEMs using car interiors to distinguish themselves from their competitors is one that is accelerating in every region around the world. "This trend is important," he insists, "and it means we have very dynamic relationships with the companies that supply us with foam, fabric, leather and all the materials we use. The complexity of those relationships is not really an issue; that's how things work with a number of components."

His contention is that the relationship Lear Corporation has with tanners around the world is strong. Before the Eagle Ottawa acquisition, Lear was already buying crust from a number of tanners and finishing, cutting and sewing the material at a finishing and cutting plant it runs close to Ciudad Juárez in Mexico. The Ciudad Juárez plant now reports to Eagle Ottawa, which reports to Mr Scott, and the division president's perception is that the change is going smoothly. "We continue to use multiple suppliers," he says, "and while this means we retain information on logistics, capacity, currency rates and so on, we leave it completely up to our suppliers to make wet blue and crust for the best cost they can and only make our selection from there."



Lear Corporation chief executive, Matt Simoncini, receiving a community award in Detroit. He has said the growing popularity of leather among car-buying consumers was one of the factors that persuaded his company to move for Eagle Ottawa.

CREDIT: LEAR CORPORATION

Knowledge, expertise, experience and the finishing capacity of Eagle Ottawa give his company a distinct advantage over its rivals, Mr Scott concludes, putting it "in a great position to drive value for customers".



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