Reprint

Wire Harness Myths

As featured in the
May/June 2013 issue

Serving the Electric Wire and Cable Processor
WIRING HARNESS NEWS®
Voice of the industry
P.O. Box 527 • RICHMOND, ILLINOIS 60071

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By Loren M. Smith

A myth is an often-repeated story, which becomes a widely held belief that may have absolutely no basis in fact. There are many myths surrounding the wire harness industry. Here are 5 wire harness myths I will attempt to dispel in this article.

1. The industry drives gross margins to levels (i.e. 18%) that make it difficult if not impossible to achieve a respectable bottom line.

2. Harness companies with strong customer concentration (high percent of revenue with very limited number of customers) are very risky.

3. Wire harness manufacturing is a "me too" business with no technological content.

4. Small (under $10 Million revenue) harness manufacturers are at a strong disadvantage compared to much larger harness companies, and thus should not be considered viable sources for OEM's.

5. Wire harnesses produced with US labor simply can't compete with much cheaper foreign labor.

Why should anyone care about these wire harness tales?

When these myths create a barrier to the interest of your wire harness company, you care.

Facts abound to refute all 5 of these widely held mythical beliefs about our industry.

Loren M. Smith, CEO
Blue Valley Capital

1. ***The market drives gross margins to levels (i.e. 18%) that make it difficult if not impossible to achieve a respectable bottom line.*** It's true that many of the markets wire harness compares serve drive gross margins to the high teens (gross margin is what you have left after paying for direct and indirect labor, factory overhead, and material). When you are operating with an 18% gross margin, unless your operating expenses (or administrative expense) are very thin (5 to 8 percent), you will indeed have a dismal bottom line. The degree to which harness companies can make this model work is highly variable, and in my experience follows the normal distribution curve. There are many harness owners who are able to operate with very impressive bottom lines despite relatively low gross margins, while some harness companies just get by. The difference between those who make serious money and ones who do not is not a function of the harness business, and relates strictly to the skill the owner and his or her management team. It's this difference that drives the bottom line, not the wire harness business per se.

2. ***Harness companies with strong customer concentration (high percent of revenue with very limited number of customers) are very risky.*** Small or medium size wire harness businesses often have very strong customer concentration. i.e. a high percent of revenue with a few customers. Here's a fact that refutes this myth: a wire harness company with 2 customers accounting for 80% of their revenue sold for 6.5 times EBITDA. This multiple is the very high end of the spectrum for manufacturing companies this size. (This company had revenue of $23M). Why did a sophisticated financial buyer pay an exceptional multiple for this company with such high customer concentration? The buyer took the time to understand the value of this company's customer relationships; he saw the exceptional level of mutual dependence, i.e. the degree to which these customers relied on this wire harness supplier. He saw just how difficult it would be for both of the company's big customers to change harness sourcing, and he saw that these customers were world class OEM's with huge growth potential. Other buyers looked at this company, saw the customer concentration and ran the other way. In this sense myths are like prejudices; when someone holds an opinion based on prejudice, it's very difficult to change their view.

This example is not an isolated case; I have put together a number of harness sales with similar high concentration achieving a similar result.

3. ***Wire harness manufacturing is a "me too" business with no technological content.*** Tell this to an OEM whose end product sells for a million dollars; his million dollar machine will not work without a functioning wire harness, and his million dollar machine must function for x number of hours without a failure. When you understand the number of ways a wire harness can fail, you understand a wire harness might not be a patentable semiconductor, but it's not a low-tech product.

4. ***Small (under $10 Million revenue) is a strong disadvantage compared to much larger harness companies, and thus should not be considered viable sources for OEM's.*** Some large users of wire harnesses will not deal with suppliers whose revenue is less that some arbitrary number, thus showing bias toward large companies. There are many small wire harness companies whose cost structure and technical competence (ability to help their customers with design) is equal to or better than many larger harness suppliers, and, better yet, they are much more nimble (able to change on a dime). Universal access to leading edge software, cutting/terminating equipment, and JIT material vendors has leveled the playing field, substantially enabling small harness companies to effectively compete with any of the big boys.

5. ***Wire harnesses produced with US labor can't compete with cheap foreign labor.*** If this were true, there would be no harness manufacturing in the US. But the facts simply do not support this. In the Midwest alone, there are at least 20 wire harness manufacturers with combined revenue of several hundred million dollars. These companies serve customers who have all looked at harness procurement from non-US labor markets. If it made sense for them to source outside the US, they would have done so.

In many respects the wire harness business is a poster child for US entrepreneurial ingenuity. With the exception of very large automotive and appliance harness suppliers the industry is comprised of very competent entrepreneurs who know how to serve their niche markets. When harness myths create barriers for harness companies who wish to sell their business, find financing, or penetrate a new customer, it's possible to overcome these myths, but it requires a creative approach to describing your business model and the value you provide your customers.

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