

Automotive After Sales 2015

Are you ready for the battle?



Rapidly declining profit margins in the new car sales business together with the continuous extension of car life are making the after sales business increasingly important. At the same time, growing consolidation in the after sales market is putting OEMs' market share at risk. Various trends will affect market structure as well as customer behaviour and thus fuel the need for innovative after sales business models. In a comprehensive after sales study on the future global as well as regional car after sales markets, Arthur D. Little has identified future after sales trends. Based on the trend analysis and current case work experiences, Arthur D. Little has developed strategic options to help the OEMs adjusting their after sales business to meet tomorrow's global after sales market requirements.

The after sales business – profitable and highly competitive

With profit margins in the new car sales business undergoing continual erosion, high revenues no longer equate automatically with high profits. As a result, the new car sales business makes only a small contribution to profits. In fact, the after sales business, long time neglected by automotive OEMs in their business strategies, achieves a significantly higher ROS and is often the most important profit pillar. In Germany, for example, the after sales business generates more than half of profits while accounting for only 23% of revenues (including passenger cars, SUVs and light commercial vehicles). See figure 1.

Based on a global growing car fleet and an increasing average fleet age in mature markets, market forecasts show a strongly growing after sales market volume from worldwide 412 bn EUR in 2007 to 718 bn EUR in 2015. This growth is mainly driven by the rapidly growing service demand in emerging markets where new car sales boost the need for after sales services.

The highly profitable after sales business attracts new market players, which enter the market with innovative business models. Today, the after sales revenue is divided between four main after sales service provider groups: OEMs, independent garages, service chains and the do-it-yourself-segment. Many mature automo-

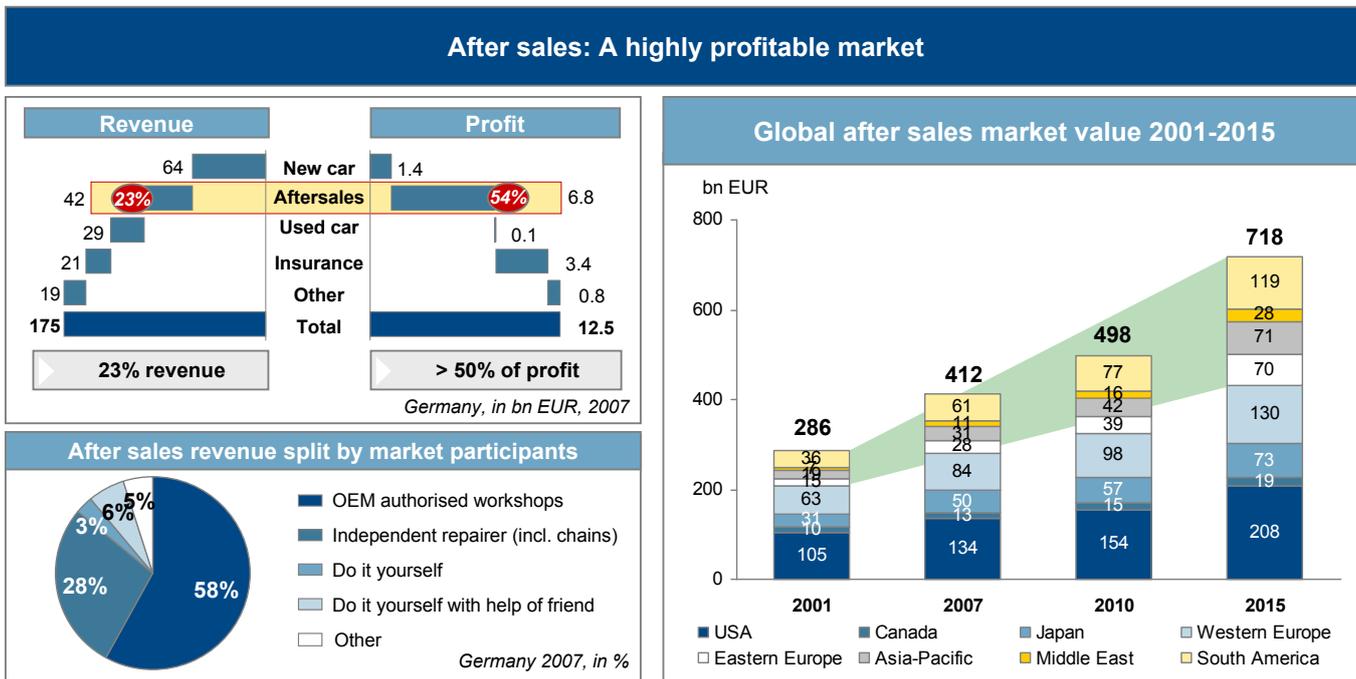
tive after sales markets, with the exemption of North America, are similar to Germany where the OEMs are still predominant with more than 50% market share.

In the emerging markets (e.g. Russia), grey market after sales services are strongly established and represent the most important pillar of low price services. On the other hand, there is a noticeable demand for high quality services. As high quality service substitutes still are widely missing in the emerging markets, the OEMs could currently achieve a higher market share in these markets.

Given a growing diversification of the after sales offering, the OEMs face a demanding challenge – maintaining their profitable after sales business in an increasingly competitive environment.

The Arthur D. Little after sales study

In order to verify the future market segmentation of the global after sales market (including passenger cars, SUVs and light commercial vehicles), Arthur D. Little has conducted a global study analysing future trends with impact on the after sales segmentation. Market research as well as strategy formulation have been conducted on a global basis with a regional differentiation of mature triad markets and growing emerging markets. Major trends have been analysed



Source: Datamonitor, AAIA Factbook 05/06, DAT Report 2008, ZDK 2006, IFA Nürtingen, Global Industry Analysts report, EUR valuation partly based on currency exchange rate from 1.3.2008: 1 EUR=1,51898 US-Dollar (Bundesverband deutscher Banken)

Figure 1: Overview of the global after sales market

regarding their implications on the OEMs' market share and revenue in three different scenarios.

The study comprises three key stages:

- Trend Analysis:** Identification and analysis of international after sales trends and their impact on the future segmentation of the after sales market.
- Correlation Model:** Evaluation of the quantitative market share and the revenue implications of identified trends.
- Scenario Analysis:** Discussion of the characteristics of the future after sales market and the quantitative impact of trends under the three scenarios.

Trend Analysis

The Arthur D. Little study identifies a number of trends set to have a substantial impact on the future segmentation of the automotive after sales market. See figure 2. These include:

- **Competition:** OEM competitors will capture market share with innovative business models, such as fast-fit chains. New service formats, such as service chains, will meet changing consumer needs. The internet will emerge as a retail channel for parts and services, enabling the sale of low-price parts mainly from South East Asia.
- **Legislation:** Changes in the legal environment will lead to a growing deregulation of the after sales business. While the block exemption will ensure

more rights for free repairers, the introduction of the repair clause, which abolishes the OEMs' exclusive right to replace visible body parts, will open this market to independent parts producers. CO₂ emission standards could open up further new business opportunities.

- **New cooperation models:** In saturated markets, third parties and after sales service providers will link up to establish a growing range of new cooperative models. Automobile associations, such as the ADAC, will increasingly influence their members' choice of repairer with incentives for choosing one of their partner garages. Insurance companies will establish their own repair network and exert pressure on the prices charged by authorised repair shops.
- **Structural changes:** In the triad markets, the increasing cost of car ownership means potential private new car buyers will postpone buying a new car or won't buy at all. This will lead to a higher market share for the stable corporate fleet segment and to an increasing average fleet age. Growth in fleet age will also be driven by improved product quality, which prolongs the life of cars. Older cars will demand more service, creating a profitable new market for residual value service offerings. In the emerging markets, growth in income will support private car purchase. The growing car fleet together with the first generation of



Source: IFA Nürtingen/CARE Studie, ADL research

Figure 2: Trends in after sales

ageing new cars will lead to a rapidly growing demand for after sales service in these markets.

- Customer requirements:** In the triad countries the importance of commercial after sales clients will grow steadily, while in the emerging markets increasing incomes and the advancement of the personal car as a status symbol will boost private car ownership. Customers will demand personalised services that respond to their particular needs. Greater product complexity will make "do it yourself" service almost impossible for newer cars.

Correlation Model

The identification and qualitative analysis of the trends is followed by a quantitative evaluation of each trend's impact on the future after sales market segmentation in a correlation model. Arthur D. Little's quantitative analysis of the trends outlined above is based on desk research, interviews and expert estimates. The model consists of a correlation matrix and a trend evaluation matrix. In the correlation matrix, the weight of each trend is evaluated according to its potential to interact with other trends. The impact of every trend on the future segmentation of the automotive after sales market is evaluated in the trend evaluation matrix and illustrated in three different scenarios.

Scenario Analysis

Drawing on the insights provided by the trend analysis and the correlation model, Arthur D. Little has defined

three possible scenarios for the future segmentation of the automotive after sales market (see figure 3):

Scenario 1: Worst Case "Collapsing OEM after sales market share"

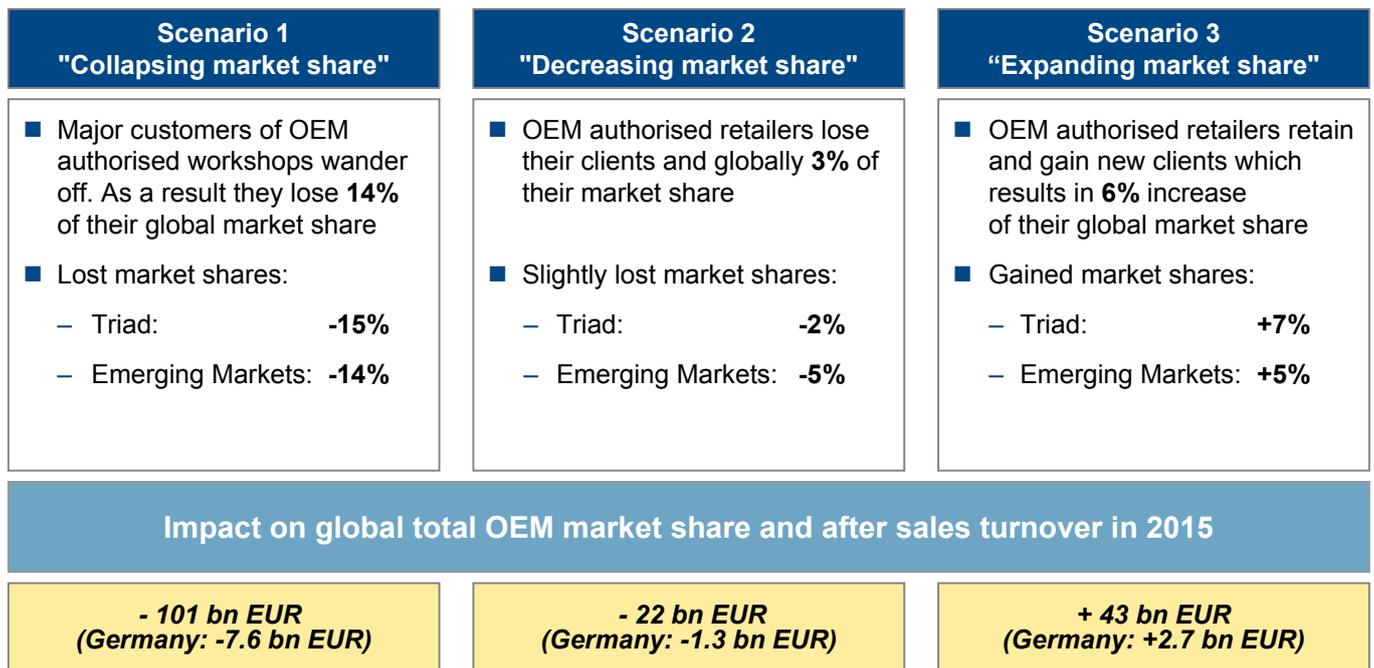
Scenario 1 describes a situation where each trend develops to have the most negative outcome possible for OEMs.

Further deregulation, including the introduction of the repair clause, takes place and OEMs experience growing pressure from competitors with innovative business models. Major customers of OEM authorised workshops find alternative service providers and, without an adequate strategy in place, OEMs lose 14% market share in the global after sales business. Worldwide, this represents a reduction in revenue for OEMs of 101 bn EUR. In Germany alone, OEMs would lose approximately 7.6 bn EUR.

Scenario 2: Real Case "Decreasing OEM after sales market share"

Scenario 2 is based on the most realistic evaluation of the impact trends will have on future after sales market segmentation.

The repair clause is introduced and independent service chains continue to grow and consolidate their business. OEMs focus on optimising existing business models and, without an innovative after sales strategy, are unable to protect their after sales market share from new market entrants. Under this scenario, OEMs



Source: Arthur D. Little Scenario Analysis;
 German turnover was calculated applying the relative OEM market share loss in the triad market on the OEM market share in Germany

Figure 3: Market share and revenue implication of defined scenarios

lose 3% of their global market share in 2015. This represents a loss in global revenue of 22 bn EUR (1.3 bn EUR in Germany alone).

Scenario 3: Best Case "Expanding OEM after sales market share"

Scenario 3 describes a situation where each trend develops to have the most positive outcome possible for OEMs.

The existing block exemption is abolished in 2010 and OEMs introduce a successful residual value service offering which increases customer retention. The OEMs are aware of the growing competitive situation and enter the market with new disruptive business models and strengthen their market position. The OEM authorised retailers retain and gain customers and increase their after sales market share by 6%, leading to an increase in revenue of 43 bn EUR globally. In Germany alone, the OEMs increase their after sales revenues by 2.7 bn EUR.

Developing a battle plan

Any strategy for after sales needs to incorporate improvements to both the spare parts and the service aspects of the business. It should address the global after sales market as well as incorporating strategic measures adapted to reflect specific customer requirements and market structure in the triad and emerging markets. A comprehensive after sales strategy will both defend and increase after sales turnover in the

triad market and develop new after sales turnover in the emerging markets.

Arthur D. Little has identified a number of strategic options to help OEMs prepare for the battle:

Global strategic options

The following strategic options are relevant for established and emerging markets:

- **Life cycle-based service offering (for cars aged 4+ years):** The introduction of a OEM second brand service chain offering the most common types of after sales service at a low price would reduce the customer migration that accompanies growing car age. Moreover it allows OEMs to benefit from the current trend towards service chains.
- **Downstream integration of after sales services:** The first customer contact when selling a new or used car should be used to effectively increase customer loyalty in the after sales business. Therefore OEMs need to further develop mobility packages and flatrates including after sales services and need to actively sell them together with the car.
- **Target group specific after sales solutions for private car holders:** While some new car buyers expect premium services, used-car buyers are

more likely to choose life cycle-oriented service offerings. OEMs need to segment individual after sales groups and target them with specifically designed services. Examples could be an after sales factory with low-cost services for price-sensitive customers or inspection services during business travel for busy professionals.

- **Life cycle-based parts:** The OEM spare parts portfolio needs to include adequate residual-value alternatives to new parts. These can be used parts or remanufactured parts. OEMs should more aggressively communicate their low-cost alternatives to current and future customers to increase customer loyalty.

Strategic options for the triad markets

Facing legislative developments and changing market structure in triad markets OEMs need to address these markets with specific strategic options such as:

- **Stronger focus on fleet business:** Introducing an OEM business centre dedicated to serving fleet customers would increase fleet business. In addition, innovative mobility packages for small car fleets would increase fleet service turnover.
- **Parts retail channel innovation:** With the block exemption 1400/2002 encouraging authorised workshops to source their spare parts from third-party suppliers, OEMs need to become independent of the demand for parts from authorised workshops. This means OEMs need to expand their parts retailing and start supplying independent repair shops and service chains as well as entering the online market.

Strategic options for emerging markets

The emerging markets offer a substantial growth potential. At the same time these markets confront OEMs with wide variations in economic development (urban vs. rural areas), consumer spending patterns (rich vs. poor) and vehicles under service (new vs. used). Arthur D. Little proposes a number of strategic options for these markets:

- **Market segmentation:** OEMs need to identify market clusters, according to indicators such as purchasing power and vehicle population by make, model, and age, and allocate resources and define growth strategies accordingly.
- **Retail strategy:** Defining and ensuring a consistent retail strategy is one of the most important steps in emerging markets. Significant differences between developed urban areas and underdeveloped rural areas make it necessary to develop a range of retail formats that can nevertheless be implemented consistently.

- **Qualification and training:** In fast-growing emerging markets people are key. Only with a qualified workforce can OEMs tap into the potential for further growth. A systematic approach to HR issues is therefore a must.

Conclusion

The analysis of the automotive after sales market by Arthur D. Little has shown a potential risk for OEMs. Growing competition, legislative changes, the shift of growth in after sales turnover to emerging markets and the growing differentiation of customer requirements all threaten OEMs' current revenue and profit situation. However, OEMs can transform the threat to their after sales business into an opportunity for growth by developing an effective after sales strategy. Based on an analysis of trends in after sales and their likely impact, Arthur D. Little has developed a number of strategic options to help OEMs increase their after sales revenues and profits. However, future success in after sales for the OEMs depends on their willingness to rethink their current business and to apply the strategic options proposed in order to optimize their current business and to develop new business models.

If you would like more information or to arrange an information discussion on the issues raised here and how they affect your business, please contact:

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About Arthur D. Little

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