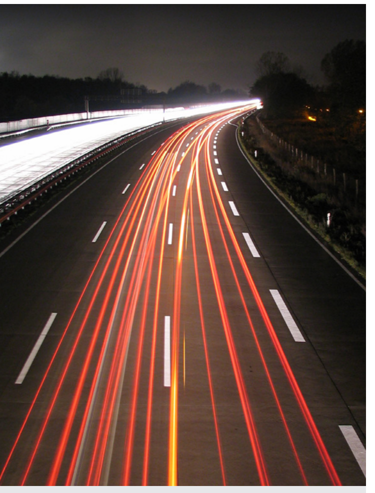
Aftermarket business – Crisis stronghold in the automotive industry?

A.T. Kearney has conducted a European survey to analyze the impact of the crisis on the automotive aftermarket

The good news first: the crisis is expected to hit the European automotive aftermarket only moderately. The impact differs significantly from region to region, however. Full recovery is predicted to take more than 36 months. Besides impacting the size of the aftermarket, structural changes will be accelerated as a result of the crisis. In particular, an acceleration in the trend toward smaller cars and engines as well as a reduced car usage – at least in the short term – will affect the aftermarket. The winner emerging from the increased cost consciousness of private and business customers is the Independent Aftermarket (IAM).



In response to the crisis, automotive aftermarket players not only apply "typical" crisis measures, such as liquidity optimization, but also adapt their long-term business plans.

Crisis impact differs by region

The automotive industry in Europe has been affected significantly by the financial and economic crisis: new car sales have dropped by double-digit percentages, diminishing residual values have driven retail and financial services into deep reds, and new car discounts have reached unusually high levels. It seems that the aftermarket business is one of the few areas of stability for automotive companies, and it is of considerable importance for their financial performance. This raises the question of the extent to which the aftermarket business can fulfill the hopes of automotive suppliers, Original Equipment Manufacturers (OEM), car dealers with their Original Equipment Service (OES) workshops, and Independent Aftermarket traders and workshops (IAM).

Overall, our survey indicates that the European aftermarket is expected to be hit only moderately by the crisis. Nevertheless, the experts surveyed foresee a further aftermarket decline in 2010. Business in Western Europe is expected to decline by up to 2.5% and in Eastern Europe by up to 4% during 2010. (European performance in Q3 2009 was down on average between 2.1% in Western Europe and 5.3% in Eastern Europe compared to Q3 2008). The survey also reveals that the impact of the crisis differs significantly from region to region, with Eastern Europe and Southern Europe – primarily Spain – most affected.

A recovery of the aftermarket depends on many factors, e.g. the development of the overall economy within these countries. With this uncertainty in mind, the European aftermarket is not expected to recover fully until after 2012 *(see figure 1)*.

Structural changes will accelerate

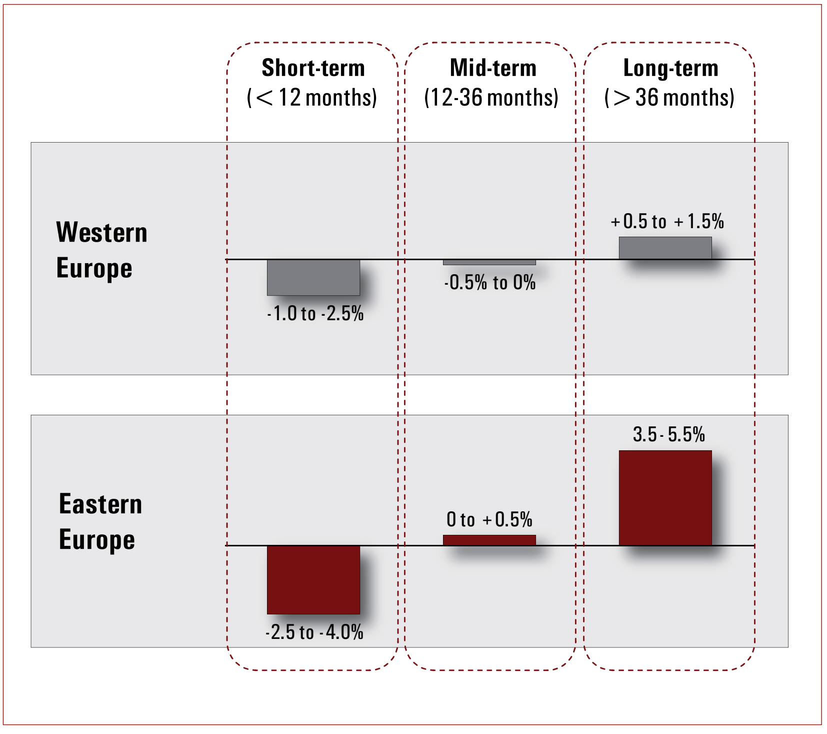
This research of leading top management consultancy A.T. Kearney is based on an online survey and interviews with 70 executives responsible for automotive aftermarket operations in Europe. The survey was conducted between September and October 2009.

The study also analyzed the impact of the crisis on key structural drivers of the aftermarket. Among potential structural changes, an acceleration in the trend towards smaller cars is particularly apparent as a result of the crisis. On the other hand, no major impact is envisaged as regards the age and size of vehicle fleets. This indicates that flexible individual mobility, i.e. the numbers of cars per household, will not be sacrificed. Furthermore, cost savings resulting from a reduction of "miles driven" are seen as a short-term, temporary effect only. Overall, it is expected that people will return to normal, pre-crisis behavior comparatively soon.

A key structural impact on the product portfolio is anticipated. Survey participants expect that demand for low-cost specifications will increase and that a low-cost spec segment will emerge for more subcategories. This means that for wear and tear parts, for example, "new" low-cost spec levels will be established *(see figure 2)* below the specification levels currently offered (frequently named: good, better, best). This development is particularly strong in Eastern Europe, but Western European markets are being increasingly penetrated as well.

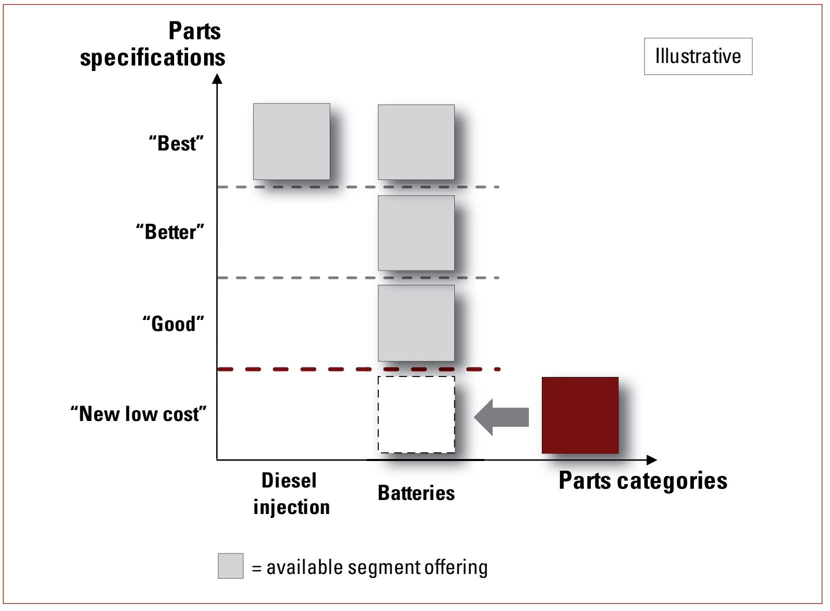
This development presents a challenge, especially for suppliers who strongly promote the Original Equipment (OE) quality of their aftermarket products. Suppliers have to decide whether they want to and are able to serve this segment at all. If so, they need to make up their minds whether they want to expand and possibly endanger their OE image or undertake the considerable effort involved in launching new "low-cost" brands.

FIGURE 1: Aftermarket development



Source: A.T. Kearney

FIGURE 2: Crisis impact on product portfolio



Source: A.T. Kearney

The Independent Aftermarket benefits

After closely examining the market overall, the survey assessed the impact of the crisis on different aftermarket players and sales channels.

Survey results indicate that OEMs, suppliers and car dealers are affected most by the crisis. This is not primarily due to the development of aftermarket business, but to the development of new car sales and related factors. The winners are clearly to be seen in businesses which primarily focus on repairs and service, such as the IAM.

The overwhelming majority (80%) of survey participants expect the IAM to benefit from the crisis with an estimated market share increase of about 2-2.5% in the midterm *(see figure 3)*. The key reasons for this can be seen in the growing cost consciousness of consumers and the clear expectation that leasing companies and fleet operators in general will channel repairs of their cars to IAM garages to an increasing extent.

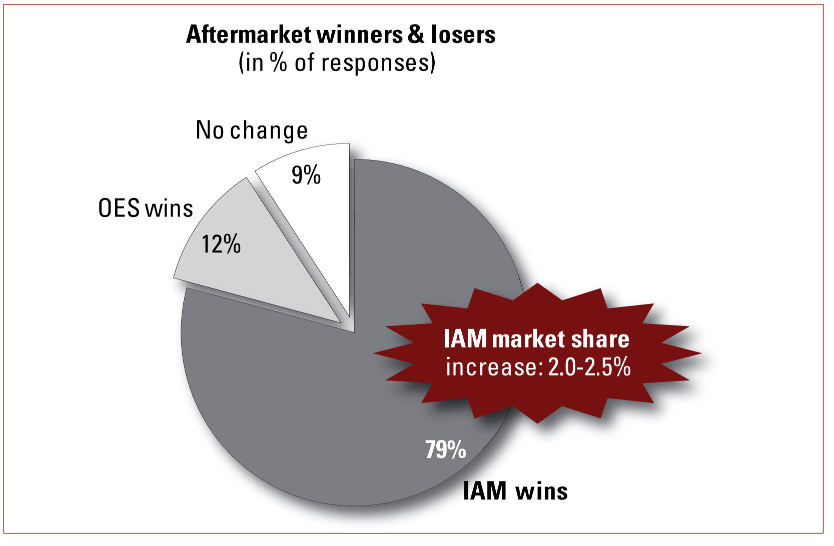
Car scrappage schemes, which are clearly seen as an advantage for the OES channel in the short term, are not expected to have a major mid- to long-term effect. The main thinking behind this judgment is the expectation that those new car owners who primarily purchased smaller, more affordable cars will return sooner to the IAM than the average buyers of new cars.

Counter strategies go beyond "typical" crisis measures

The final part of the survey focused on the impact of the crisis on key competitive strategies and on measures to overcome the crisis.

Participating companies are doing their homework. Typical liquidity

FIGURE 3: Aftermarket winners & losers:



Source: A.T. Kearney

and profitability measures to combat the crisis are high on the agenda of most of the companies surveyed. A reduction in net working capital and the restructuring of personnel costs are among the chief measures indicated. Free cash flow turned out to be the number one KPI on the watch list of senior management.

In addition, the survey revealed that more than half of the companies have changed their long-term business plans in response to the crisis.

Furthermore, survey participants see an intensification of key competitive strategies. An acceleration in acquisitions in the IAM and intensified global low-cost sourcing efforts, in particular, are foreseen by over 90% of executives surveyed.

The road to success

The crisis has shown many companies how vulnerable their business can be in severe economic downturns. Strategic deficits and operational inefficiencies have been revealed – mercilessly. To ensure that they are better prepared for the future (and the next potential downturn), companies should:

- **Optimize product, customer and regional portfolios.** Only highly diversified companies will be able to mitigate future risks and at the same time benefit from market growth. Companies with global aspirations especially should ask themselves whether the revenue and profit share generated in the BRIC countries reflect current and future market shares of those promising regions.
- **Improve operations performance.** Optimizing net working capital should become a standard routine with a high focus throughout the year, irrespective of the economic situation. For many companies it seems to be the right time to consider the (re-)introduction of management concepts such as continuous improvement, lean management and other operations excellence concepts.
- **Increase customer centricity.** Establish a company mentality, not just a sales approach, which makes the customer the focal point of all employees. Especially during the crisis, companies appreciate the value of well-established, trust-based customer relations. Offering those top customers a truly differentiating service requires the clear segmentation of customers and a genuine differentiation of customer-related measures, depending on the segment. Each department, including support functions such as IT, needs to ask itself what it could potentially contribute to further improve customer service.

Authors:
Dr. Martin Haubensak is a partner in the Duesseldorf office and can be contacted at martin.haubensak@atkearney.com
Armin Landgraf is a principal in the Frankfurt office and can be contacted at armin.landgraf@atkearney.com
Alexander Wuensch is an associate in the Berlin office and can be contacted at alexander.wuensch@atkearney.com

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For more information please contact

A.T. Kearney GmbH
Marketing & Communications
Kaistraße 16 A
40221 Düsseldorf

Tel.: +49-(0)211-13 77-0

Email: marcom@atkearney.com
www.atkearney.de