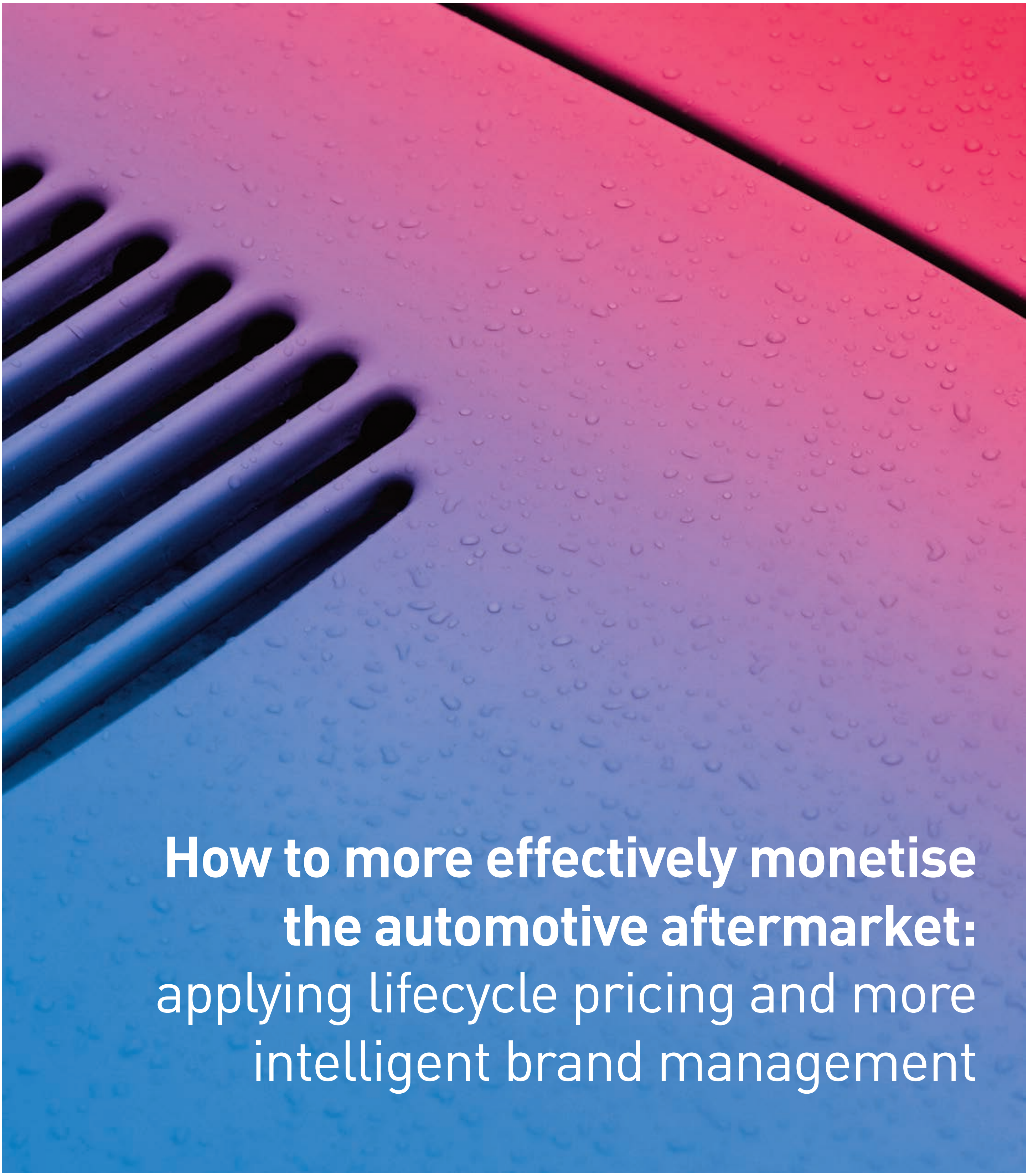
aep+ automotive intelligence



How to more effectively monetise the automotive aftermarket:

applying lifecycle pricing and more intelligent brand management

There are many great companies designing and manufacturing automotive components including service parts. Some have substantial OE mandates - brands like Hella, Bosch, Mahle, SKF and GKN etc and are global component and distribution players operating within the vehicle manufacturing (VM) arena and the independent aftermarket (IAM). Yet many firms, including the vehicle manufacturers themselves and their genuine replacement parts programmes, appear to struggle to make money or appropriate margins from their products, R&D and supply chain logistics investment. Why is this and how can they transform?

I'm afraid the reason for much of the financial underperformance lies with relatively poor decision making and leadership at parent and board level. Management would benefit from a longer term, more holistic approach. If they proceeded in this way, they would add percentage points to EBIT and have very different-looking aftermarket operations. Still reading? Good - so let's address the four things that could reset many of these businesses, transform profit, and deliver valuable operational enhancements. They are; **pricing strategy, brand management, technical fitment pedigree and tactical marketing.**

Caveat - I know it's not easy but...

It's true that each part has its own cost structure, failure timeline and many are sold independently or bundled within service prices making pricing complicated. There are also hundreds or thousands of part numbers for some companies to manage. Getting 90% of your pricing correct and 10% wrong, can significantly impede profitability. All too often, intelligent pricing comes as an afterthought.

Beyond the internal challenges, lie equally tough external challenges - extensive competition, counterfeiting and product piracy (GM reckons it costs them 10-15% annually), and increasing distribution costs. Think about it - every box or carton out there in the IAM that is unprotected by anti-counterfeiting measures, is a potential attack on your business and could create downward price pressure and reputation problems in future.

Principle - as pioneers in design and engineering, OEM component manufacturers should be able to make substantial improvements in operating revenue margins over time.

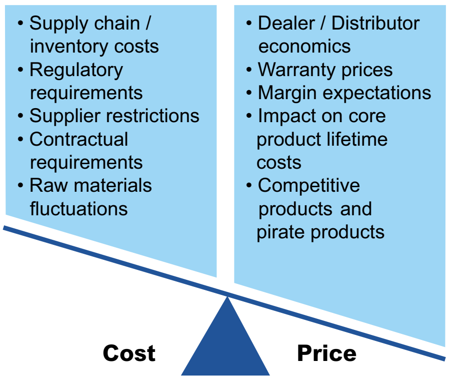
This calls for revisions to the pricing metric (is cost of ownership as a matrix an accurate reflection of component cost?), effective anti-piracy programmes, long-term planning, investment in and better brand management, plus changes to how component manufacturers market and sell to the trade. There are opportunities to be far more proactive and less reactive. Let's begin with pricing.

1. Intelligent lifecycle pricing

Technology is now mature enough to help companies manage vast amounts of data required to carry out a lifecycle pricing strategy. Lifecycle pricing involves looking at the entire lifecycle of a given part to determine the most appropriate price to charge at each stage from product introduction to retirement. Implementation can substantially increase profitability of your parts business.

Some problems you will come up against

- parts can move very swiftly through a lifecycle
- manufacturers need to define and identify key triggers for various lifecycle events - expiry of warranty, VM demand, sales into the IAM, the entry / exit of competitors, obsolescence in technology, relative cost against vehicle value etc
- manufacturers must carefully segment the market by customer need, and propensity to buy / fit at a price point - not at all easy to pull off

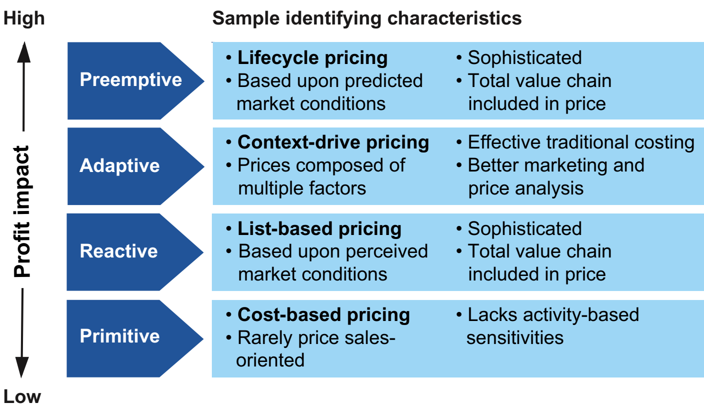


Lifecycle pricing can help balance cost and price

How companies set, manage and justify their pricing can move EBIT by percentage points. I talked to a VM recently who maintain an 'all-makes' (global) parts programme whose top-selling part was a Ford Transit Van clutch - yet the VM was not Ford. What does this tell you about their pricing strategy?

The level of maturity of a company's current pricing strategy should drive investment in additional pricing strategies, sales and distribution marketing activity, and brand communication.

Pricing maturity model



Cost-plus pricing - the most common method employed across the IAM. However this often impedes profitability mainly because; customers securing special price concessions (and / or rebates), represent direct margin erosion on net retained profits which no-longer totally cover cost plus reasonable margin; price rises are directly felt by customers and can create confrontation and pain points in the relationship; price rises also send a signal to peers and can open doors for competitors to tactically compete on price.

List-based pricing - a more sophisticated pricing strategy that tracks competitor pricing and market sensitivities. However, this model also often leads to lost revenue. It can become too selective, driving costs down and moving products towards commodity status. OEMs have a genuine part story and premium profit opportunity that becomes negated if 'best fit', non-OE parts are directly compared, or if for application sake, a remanufactured part is compared by price to a reconditioned part. Manufacturers who do not educate the market about product, specification and tolerance differences and who compete on list-based pricing strategies, are underselling their product.

Context or point of sale pricing - uses technology and data to analyse your customers' (typically an importer / export agent, wholesaler, distribution re-seller, franchise dealer, but it could also be a garage, fitting centre or a retailer for example) selling price in the market to the end user. This can introduce imbalance because wholesalers do not always acknowledge agreements and look for additional discounts on products purchased in higher quantities. This indexes turnover on to the next rebate and progressively erodes the manufacturers' margins over time.

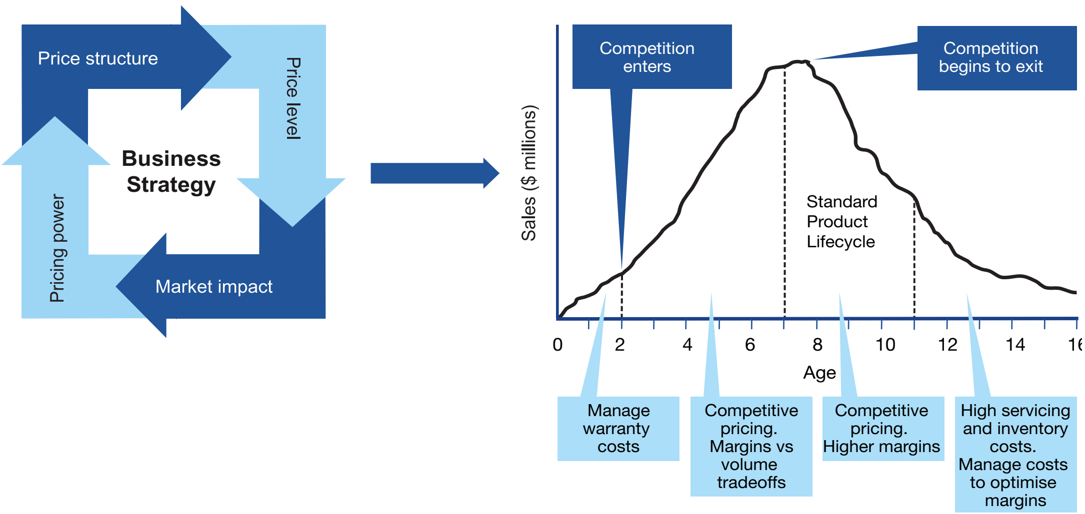
Lifecycle pricing - perhaps the 'best in class' pricing strategy involving a detailed analysis and understanding of product and customer strategies at different points in time. Whilst not every part in your catalogue will require lifecycle pricing, many will - in order to provide the desired uplift in revenue, to satisfy trigger events and enable appropriate segmentation in the market.

Tips to consider for lifecycle pricing segmentation

- look at the degree of differentiation, the value proposition, product availability, product quality, replacement rates, market share, purchase loyalty and price sensitivity across the lifecycle of each product
- build a transaction history to understand the speed at which products pass through the market
- focus on the customers' needs (not their expectations)
- avoid the temptation to over segment (it only increases confusion)
- include remanufactured an reconditioned product and maintain a standard guarantee
- think beyond the 90/10 rule where 10% of parts provide the vast majority of revenue. The 10% portion is probably where extensive competition exists. There will be significant lifecycle pricing uplift opportunities in pockets of the remaining 90%
- don't overlook direct competitor pricing and non-technical compete parts from 'best fit' rivals. The major challenge is with reconditioned and remanufactured competitors
- do consider the lack of knowledge and fragmentation of distributor networks. Be prepared to mount education and enlightenment communication programmes to explain varying quality in the market and impact for end users and garages.

Price change drivers

The chart below illustrates the lifecycle pricing concept over time.



The golden rules - do your homework well, set pricing, review costs (if you are a premium brand with a premium price, do not erode any prices if you don't have to), and test your price strategy.

Desired and realistic results - Deloitte in the US have estimated that returns can be as much as seven times the return in margin for the upfront analytical investment. They also report witnessing an improvement swing of 2% to 5% in realised revenue. AEP advertising saw a 4% swing on LuK passenger car following realignment of pricing and a communication programme.

2. Changing your approach to brand management

Brands need a purpose beyond brand experience. They must drive better business systems and outcomes and educate wholesalers and garages

What is the difference between a Varta battery and an equivalent Exide battery? Or a NGK spark plug and, say a typical equivalent Bosch plug? Or Shell's "Helix" range and an alternative motor oil? And so-on. Beyond availability and price, the obvious differences are; brand, brand experience and perceptions in the minds of the specifier - the fitter.

Most sales and marketing managers and general or country managers, pursue a product strategy rather than progressive and integrated brand story management. Externally, a battery looks like nearly every other battery - to the trade and especially among end users. Equally, most motor oils look and perform much the same function. In Bahrain recently, I asked countless people what brand of motor oil they had in their cars (Porsche, Mercedes, Audi, Toyota, Honda drivers). Few knew or had considered this. They didn't know if their cars had synthetic oil, or what was good for their vehicles. Yet these people mostly all drove expensive, privately owned cars. It's partly ignorance, and mostly the fault of oil and lubricant manufacturers many of whom haven't been tough or consistent enough with brand management over a sustained period. The same isn't true of computers for example - we are PC or Apple people and we know which.

Establishing and maintaining brand power

Companies don't create brands, people do. Companies create new products, services, names, logos and packaging – but it is people who give these creations life and longevity by relating to them, buying-in to them, consuming and re-purchasing. The brands that do best are the ones that engage and connect with consumers effectively.

Selection, purchase and recommendation of a product, tends to be both an emotive and personal decision drawing on personal values and brand values.

Key values requiring alignment (for carmakers with purchasers)	Key values requiring alignment (for component manufacturers with purchasers/fitters)
Value for money	Capability
Exciting drive	Performance
Performance	Honesty / integrity
Technological	Price
Good design	Quality

Component manufacturers face different challenges and value triggers when planning their products, technology and fitment stories. Price for example, is a key factor for people buying cars as much as it is when buying a battery, set of brake pads, oil change etc – but price doesn't tend to have the same influence over consumption when it comes to selecting or buying a component. How many of us know within 15% what a set of spark plugs for our car costs, for example?

Component manufacturers who work carefully to build brand stories that resonate with key values among fitters / specifiers / the trade, will be best positioned to build profitable, sustainable, healthy sales and marketing platforms and recurring revenue with less need to discount or respond to 'best-fit' peers.

Establishing and maintaining the 'brand experience'

'Brand experience' is a term used to describe the total impression of a consumer of a brand (end user or trade specifier in this case). It's a sensory / total experience, stemming from advertisements and every conceivable 'touch point' with the company and its products – from sales visits, samples, pricing, availability checks, PR, warranty claim experience and so-on. It's a psychological determination – and therefore a highly valuable concept because manipulation of that experience can yield higher profits.

For the brand experience to be strong, it must present a clear and unified experience. Items associated with the brand must appear to perform as they are advertised, because the use of the product should not contradict expectations.

Let's take a service part like oil and lubricants. Clearly for a manufacturer to build, defend and maintain market share, it must invest in and maintain a good brand experience. But in this example (oil for your car), what should the brand experience focus on and deliver? Being readily accessible or available and sensitively priced – are prerequisites. Being able to withstand 1% higher temperatures is irrelevant for the garage and the end user. And since most motor oils look like each other and perform much the same function with similar results, in this example, brand experience must necessarily be not just about the product.

To carve out, win and maintain sales, an oil company will need to focus on the garage / fitter and carefully define and present the brand experience in such as way that it appeals to, excites and convinces the trade to buy, recommend and fit. In this case, as in many others, a winning brand experience will need to be built around five key levers;

- Product (integrity, fit for purpose, range)
- Service (total manufacturer's commitment needs to come across)
- Marketing (fit for the 21st century)
- Support (technical fitment, application guides, apps etc)
- Communication (every aspect from talking to all employees to the garage's customers)

Over and above these five levers, some manufacturers will have to mount consumer-facing communication and advertising strategies to raise awareness, educate end users, differentiate as best they can, maintain visibility and demonstrate to trade channels that they are investing in their products and technology.

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Establishing a positive fitter perception for your product

In the IAM, the fitter / garage mechanic or owner / manager, is often all important and typically the largest influencer when it comes to choosing which parts or products or brands are fitted. Fitters know if a type of clutch is hard to fit, or is typically more difficult and time consuming to fit, or doesn't come with the same helpful fitting tips and instructions, or if a part is priced in such a way as to commonly be challenged.

Equally, not every garage mechanic is comfortable fitting and recommending a premium-priced battery for example. However, manufacturers who invest heavily and consistently and constantly in trade channel marketing – with multiple 'touch points' (feeding and building the brand experience), will be best placed to drive popular fitter perception in the IAM and ensure familiarity, top of mind awareness, technical fitment perception, correct fitment pedigree.

Fitters are consumer too – so how should manufacturers proceed?

German OEMs are among one group of manufacturers who often appear dazzled by the look of their products (every rivet for example). Many like nothing better than to see a large picture of their product and view this as their brand. They're wrong. Component manufacturers need to be more imaginative and think beyond product photography to build fitter perceptions. A product-led visual communication strategy is not a sustainable strategy that truly differentiates a manufacturer, exciting the trade, or translating through to end users. Neither will it enable the manufacturer to justify premium pricing.

Best advice – reduce dependency on product-led visual language and focus on building a brand and brand experience. Apple, Bose, Coca Cola, Virgin, Sony, Google, Land Rover and Dove for example all adopt brand-led strategies and still illustrate product in their visual language - but product is not always centre stage.

3. Building a technical fitment reputation

Establishing and defending a manufacturer's technical fitment reputation is key to building a successful, profitable IAM business. For OEMs, it should be easier because they have the OE story to leverage.

Building a technical fitment reputation takes time and requires senior management, sales managers and marketers to be aligned and consistent in 10 key areas;

- Positioning of parent company
- Creativity when leveraging the OE story / relationships
- Application-led / quality messages (strong product differentiation)
- High quality advertising and related materials
- Innovation and continuous OE fitment propaganda
- Premium pricing (and premium profit opportunity)
- Superior service
- Unrivalled technical support
- High quality packaging
- Anti-counterfeiting and anti-product piracy programme that trade see and feel

Advertising example

Good advertising requires investment in creativity, the brand and marketing agency, materials and their specification, photography and so-on but pays off in spades when it comes to maintaining price and building brand experience and technical fitment reputation. Whilst one creative solution will seldom work for one product across 20+ countries and multiple regions, managers at parent level should be able to commission a cross-section of advertisements, visual language and copy treatments that relate to local markets (and culture / taste), maintain globally consistent brand messages and progressively build the technical fitment reputation.

Which of these ads do you think is more effective in establishing a technical fitment pedigree?

Media selection and investment

For best brand and pricing results, manufacturers need to think about the IAM as one market – albeit most will compartmentalise into regions (EMEA, MENA, the Americas, CEE, Asia Pac). In most cases, there will be multiple trade press media channels that reach a combination of fitters, service managers / dealer managers with service / parts responsibility. Rarely can advertising in a single channel be justified. Ordinarily, it takes a sustained investment across multiple channels – press but also via apps and online, to drive fitter perception and technical fitment reputation. However media expenditure can be managed centrally with an approved media roster approach and deeply leveraged media buying to ensure maximum opportunity to see. Manufacturers investing beyond annual or special product features – by investing in a continuous high impact, rolling awareness programme, will be more successful building and maintaining their technical fitmentreputation.

4. How tactical marketing can support business growth and transformation of revenue

'Tactical marketing' is about coordinating product name and packaging, pricing, company positioning, advertising, brand experience and service to deliver market share and sales. As such, there should be nothing short term about it – unless it focuses on a disaster or product recall for example. Getting tactical marketing right, will enable the manufacturer to build a strong brand experience, together with significant equity – including greater customer loyalty, stronger trade or intermediary cooperation and support, less vulnerability to competitive marketing actions and discounting.

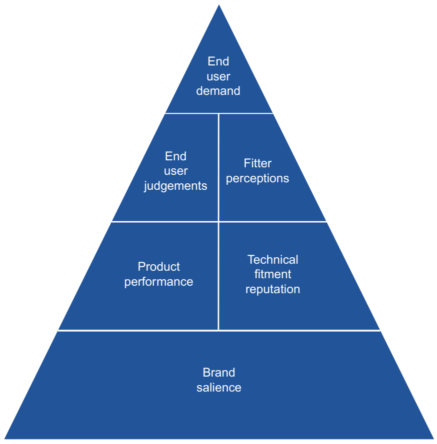
So what are the ingredients for effective tactical marketing?

i. Identification of the product range / application and manufacturer in customers' minds (for example - effective stopping, higher mileage gained from tyres, reliable battery starting ...)
ii. Firmly establish prompted and unprompted brand recall using both product and personal value attributes (capability, performance, honesty, price, quality etc)
iii. Elicit the proper customer response
iv. Convert demand and awareness to create intense, active loyalty between the customer and the product

These four ingredients are, if you like, the building blocks for manufacturers' sales activity.

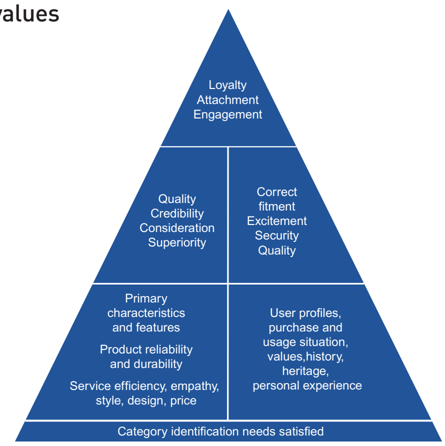
Key building-blocks to support business growth

To create some logical structure, the four ingredients can be illustrated as a pyramid – where manufacturers will only be able to build sustainable, profitable IAM operations if they have the right blocks as a foundation to satisfy end user demand.



Linking building-blocks back to personal value and brand values

Each of the six building-blocks can be subdivided to incorporate drivers and both personal and product values explored earlier in this document. The responsibility lies with the manufacturer to communicate which product or service offer sold under which brand name, is designed to satisfy which application. To maximise sales revenue, manufacturers need to invest in tactical marketing, maintain control of their distribution, justify pricing and invest in awareness and brand experience.



Manufacturers experiencing significant pricing problems can address them in part with the launch of a sub-brand or an education and enlightenment programme to underline quality, build technical fitment reputations and justify the price they want to achieve by ensuring the correct building-blocks are in place.

Summary

Manufacturing, maintaining product quality, winning distribution, ensuring distributors are efficient and actively selling-through without taking too much out of the value chain, nurturing end user demand and building technical fitment reputation – it's a complex business.

The VMs are in the driving seat because they enjoy huge brand equity and are progressively getting better at aftersales. Distributors can, if the component manufacturer isn't careful, dictate and stifle sales penetration by territory. Major distributors and re-sellers require proper incentivisation by the component manufacturer. The garage / fitter is all important as a specifier of products – we have seen how they can be influenced. Price is important to get right and lifecycle pricing can increase profitability across the key segments of the market.

Regardless of whether you are a VM, an OEM or use matching quality parts when selling into the IAM, getting the four areas considered in this document - pricing strategy, brand management, technical fitment pedigree and tactical marketing right, will help you reset and / or develop more profitable, focused and efficient businesses in the aftermarket.

About AEP Advertising

AEP advertising is a creative B2B and B2C marketing agency based in London. We provide strategic communication, brand and advertising solutions for VMs and automotive and industrial component manufacturers designed to launch or grow sales and market share. We have decades of knowledge and experience in genuine parts, OEM and matching quality parts and work in Europe, the US or emerging markets. Creating brands, building awareness, achieving differentiation, justifying retail price structures, running advertising and co-ordinated marketing programmes – we help automotive companies and firms marketing insurance, fleet and other products and services, get ahead and meet their business objectives.

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