



>> BUSINESS CAPABILITIES IN AN EVOLVING INDUSTRY

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» EVOLVING BUSINESS APPROACHES IN THE AUTOMOTIVE AFTERMARKET

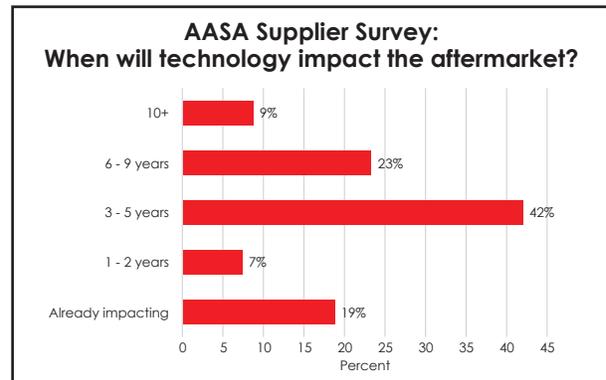
The U.S. Aftermarket industry is evolving to a variety of new and different go-to-market approaches and business models, impacting the role of product manufacturers and product suppliers to the market. After a decade of focus on aftermarket distribution channel consolidation, there are now a variety of factors that could reshape the industry model itself.

Merger and Acquisition (M&A) activity is creating new combinations of manufacturer and channel players. New in-vehicle technology will lead to a big change in market dynamics over the long term. The development of digital capabilities and the rise of online customer interactions are beginning to impact how the players in the market plan their future business approach.

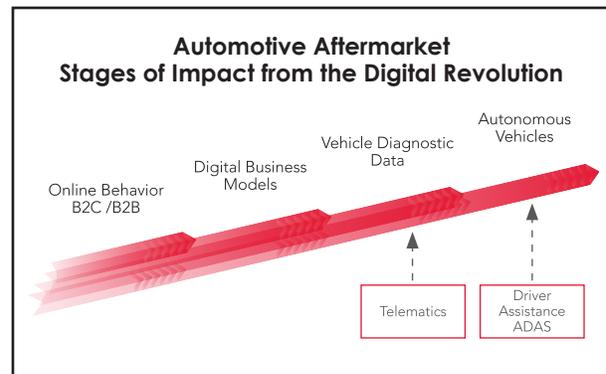
Many other industries have seen significant changes in the business practices and IT capabilities of product manufacturers at both the B2B and B2C levels. It is clear that the automotive aftermarket will be impacted going forward by digital disruption and new business models, although what opportunities will emerge is still developing.

Impact of New Technology

AASA research indicates that new technology will be disruptive to the conventional aftermarket model, and that new risks and opportunities lie ahead for its supplier members. In a recent member survey, suppliers indicated a wide spectrum in terms of the time frame for when "new technology" will impact their business.



The driving force behind this wide range of expectations appears to be the broad definition of "new technology." Certainly, the in-vehicle capabilities leading to autonomous features and connected cars will cause change over time, as the vehicle population evolves. It appears that new technology in the form of digital advancements and online lifestyles has the potential for meaningful impact in the aftermarket in the relatively near term.





Historical Supplier Business Processes

Typically, aftermarket product manufacturers have tended to focus their information technology resources on mainframe systems that supported production planning and operational processes as well as financial reporting and compliance. As a result, customer-facing systems from manufacturers served as primarily transaction platforms for the channel players (customers) who purchased product directly from manufacturers and then were shipped finished goods from the manufacturers' factories and/or distribution centers. Master data for directly-buying channel customers, including bill-to, ship-to information and pricing, was then typically housed in the manufacturers' system.

In a typical setup, manufacturers receive batch EDI stock orders from channel customers, and manufacturers' customer service centers focus on special requests or problem solving for the manufacturer to the channel.

The huge proliferation of SKUs in the aftermarket industry created local demand, increasing the importance of small parcel orders and emergency orders as a functional requirement of manufacturers. Many manufacturers bolted on web order management capabilities so that the channel customers could search inventory availability or place an emergency order. Typically, the billing transaction remained between the manufacturer and channel customer while a ship-to for a small order may be fulfilled directly to a parts store location or service outlet in the field from the manufacturer.

Impact of the Internet

The broad based use of the Internet by both consumers and businesses has dramatically changed the landscape, as rising expectations drive not only online searches for information but also the ability to place orders for shipment. Market requirements may change the capabilities needed by an aftermarket manufacturer in an online environment.

THE BROAD BASED USE OF THE INTERNET BY BOTH CONSUMERS AND BUSINESSES HAS DRAMATICALLY CHANGED THE LANDSCAPE

In general, aftermarket suppliers are facing significant challenges in harnessing the information explosion and leveraging the digital opportunities now in play. Traditional IT departments will need to adapt to the sales and marketing playbook of the mobile Internet.

As part of AASA strategy of "Connecting the Aftermarket," the association has reached out to experts in various fields of technology, in order to provide executives at supplier companies the insight that could enable their individual business planning efforts.

SAP (www.sap.com) is the global leader in enterprise application software for businesses of all types. SAP has been very active in building on its legacy to diversify its offerings and provide expertise in digital and cloud-based solutions. SAP is at the center of today's business and technology revolution.

AASA entered into a partnership with SAP to further an understanding of the trends facing automotive part manufacturers serving the spare parts and aftermarket segments. <<





» ASSESSING BUSINESS CAPABILITIES OF AFTERMARKET SUPPLIERS

In order to establish a baseline of current business processes, SAP has frequently partnered with user groups across industries. This process has created a robust set of benchmarks delineated by industry segment, peer group and common groupings of business and IT capabilities that customers deploy. AASA worked with SAP to implement a supplier survey that tailored the SAP benchmarking process for the aftermarket.

The survey of suppliers is intended to:

1. Broaden the spectrum of AASA annual benchmark survey findings with additional key performance indicators (KPIs) and best practices in the aftermarket segment, and;
2. Leverage SAP's understanding of how digital enablement will impact the business models and processes of aftermarket supplier operations.

Challenges of Business Transformation

Over the years, SAP has discovered that customers who embark on IT-driven transformation approaches can fall short on expected value delivered to the organization. While this can be the result of many different contributing factors, SAP believes that the leading causes of transformation failure include the following:

- Lack of Business and IT alignment
- Low business satisfaction from delivered projects
- Transformation is managed like an IT software project
- Uncaptured and unrealized value shortfalls
- Once a business case has been approved, there is a lack of team follow-up and accountability
- Automating current practices versus learning and applying industry and SAP best practices
- Long, risky and expensive programs (e.g. "big bang") versus shorter, managed waves or sprints

In order to address these challenges, in 2004 SAP partnered with its user group and its international affiliates to create a robust set of benchmarks delineated by industry segment, peer group and common groupings of business and IT capabilities that customers deploy. SAP introduced voluntary benchmarking as a complimentary service for its customers and prospects, with more than 60 current benchmark surveys spanning across key performance indicators (KPIs) and best practice areas supporting a variety of business models and operations. To date, participants representing more than 4,000 companies have completed benchmark surveys, creating one of the world's largest user-centric database sources in the software industry. The objective of this study is to inform suppliers in order to assist them in optimizing potential business process changes.

AASA and SAP Benchmarking Survey: Partnership for the Aftermarket

In 2015 SAP approached AASA to consider a partnership to further explore the specific market forces and transformation of the automotive aftermarket segment. The two organizations came together at a time when several AASA members and SAP customers were in flight with a number of critical changes to their business model to address rapid collapse of the aftermarket value chain. In addition, AASA members were moving to adopt digital processes to enable changes in operating processes with a focus on logistics simplification and direct market sales to end consumer/drivers.

In order to fully understand the new business models created by this trend, as well as to flush out all other specific details in this area, we created a modified and specialized benchmarking survey. «





» FINDINGS FROM AASA SURVEY

In late 2015, AASA conducted a special survey of its members to better understand where US automotive aftermarket suppliers stand today in terms of business process capabilities and what areas of focus are most important.

Online Access to End Markets

Suppliers were asked to evaluate their current and future capabilities in the areas of:

- communication (taking inquiries and information requests)
- transaction (take and process sales orders)
- fulfillment (implement the direct shipping of the orders)

Not surprisingly, virtually all members have universal capability in all of these areas with their B2B channel partners (warehouse distributors and auto parts retailers). However when asked about their end-market customers, suppliers have a very different situation with the segments we asked about: service provider chains, independent service shops and DIY consumers.

Communication

The majority of aftermarket suppliers have the capability for direct communication with the service channel (i.e. inquiries/information requests) among both service chains and independent shops. Some are expecting to add this capability in the near future. Nonetheless, it's important to note that a meaningful slice of suppliers do not have nor plan to have even this basic communication capability of taking information requests/inquires from service providers.

This communication capability is even less developed by suppliers for B2C consumers. However, this segment has the most significant movement with half of those without the ability to communicate directly with consumers looking to develop it soon.

Fulfillment

It appears that a somewhat higher percentage of suppliers actually ship directly to service providers than those that process transactions from the same group. This suggests that suppliers often ship to a service shop but bill to the channel partner. Roughly one in four suppliers is planning to add the capability of fulfilling orders directly to the shops, bringing both transaction and fulfillment capability to a higher level among suppliers.

In terms of B2C consumers, again there is a low current level of fulfillment to consumers but a very large group (47 percent) who plan to have the capability to ship to households soon.

SUPPLIERS WERE ASKED TO EVALUATE THEIR CURRENT AND FUTURE CAPABILITIES IN THE AREAS OF COMMUNICATION, TRANSACTION AND FULFILLMENT ACROSS THEIR CUSTOMER CHANNELS





Transaction

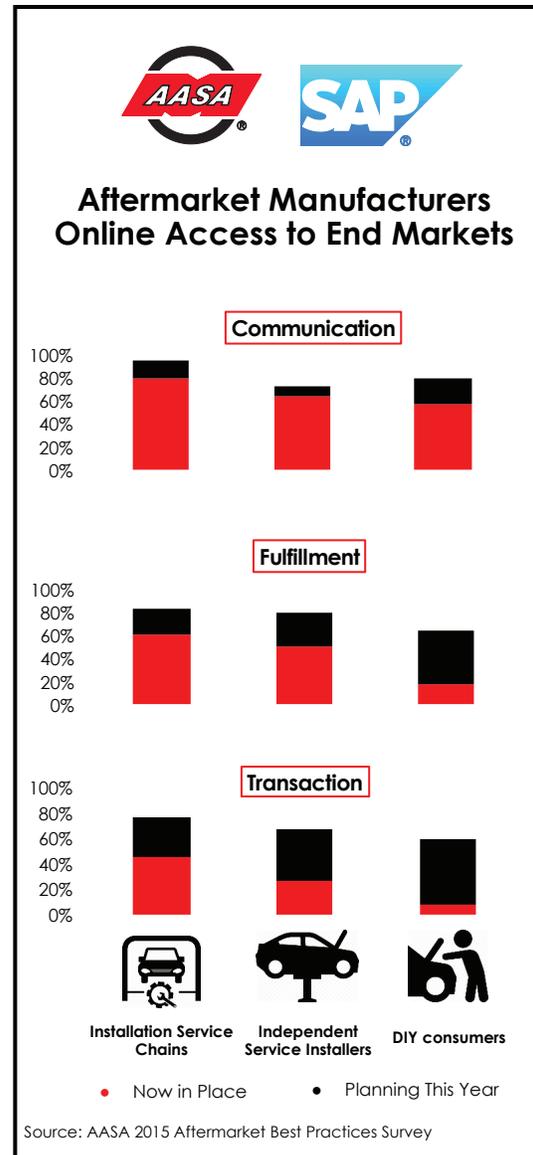
System capability among suppliers is relatively undeveloped for taking/processing orders from any segments other than direct B2B distribution channels.

With the service provider level of the market, less than half of suppliers can process orders from service chains while only one-fourth can take an order from independent shops. Less than 10 percent of manufacturers take orders from individual B2C consumers.

There appears to be widespread interest in enhancing these transaction capabilities. Based on the survey, nearly one-third of suppliers plan to add transaction capabilities this year for service chains and a similar percentage (40 percent) look to add transaction capability for independent shops. Even if these plans come to fruition, about 1 in 4 suppliers will continue to have no transaction capability with service providers of any type.

Importantly, the survey indicated that half (50 percent) of all suppliers are looking to add transaction capability directly with individual consumers. This would dramatically change the supplier landscape as only 8 percent have this capability now.

The table to the right summarizes the range of supplier capabilities now in place and those planned to be in place for the near term for "indirect" customers in the distribution channel.





Supply Chain

Based on the survey, supplier system capabilities today are not “state of the art” in terms of supply chain planning and execution as well as inventory management.

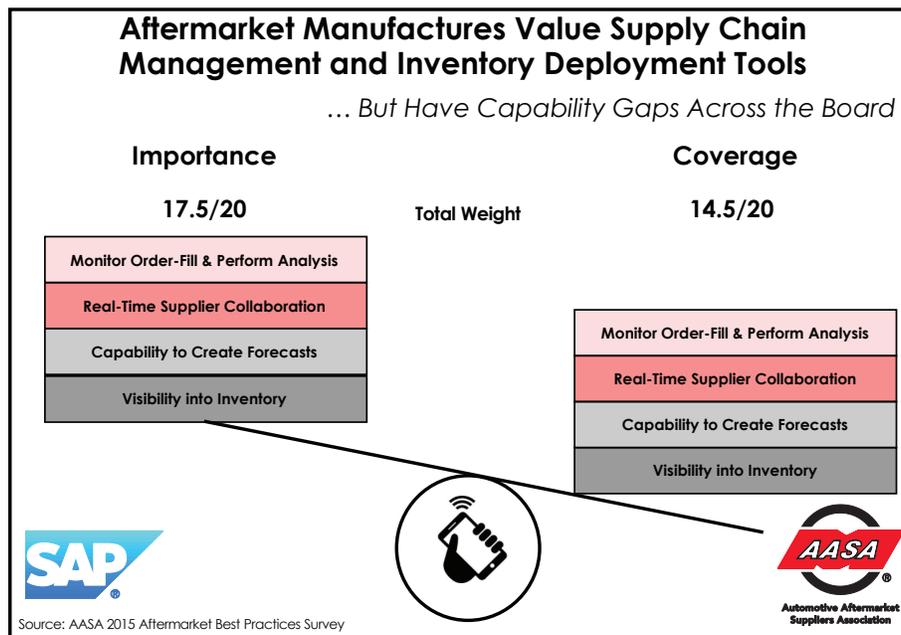
Suppliers were asked to rate the importance of certain functional capabilities and the current level of capability or “coverage” in each area at their individual company. Not surprisingly, the core activity of monitoring order fill ranks highest in importance and coverage.

Overall, the ranking of coverage in each functional area was lower than its importance ranking, suggesting gaps in suppliers’ needs and current capabilities across the board.

Key areas that were ranked are as follows:

- capability to crest forecasts
- full online/digital order taking
- real time supplier collaboration
- flexible target service levels
- visibility into inventory
- efficient storage
- integrated with key carriers
- root cause analysis of line fill rates

A similar pattern was seen in terms of gaps in inventory management capability, as these functions are seen by suppliers as important but current coverage is rated lower across attributes.





Customer Engagement

It appears from the survey, that suppliers see value in increased digitalization of the business. The primary focus of suppliers is in the customer interface and in data analytics, rather than back room functional areas.

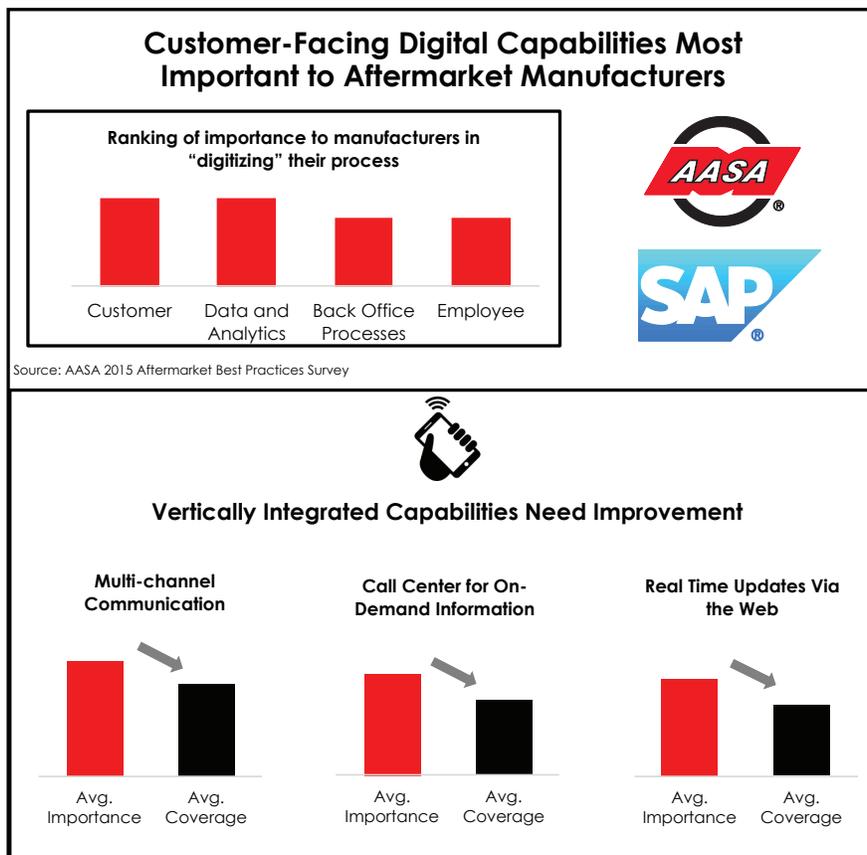
Also in the area of customer engagement, the survey indicates that suppliers are aware of the need for more integrated and “real-time” capabilities in serving the customer. Once again, importance and coverage ratings suggest gaps among suppliers in the areas of:

- multi-channel customer communication
- contact center agents with on-demand access
- sharing updates with customers over the web

Summary Survey Findings

The business practices survey indicates:

- suppliers are moving to enhanced capabilities in communication transactions and fulfillment with service providers and consumers
- supply chain processes remain focused on order fill monitoring; there appear to be capability gaps in state of the art tools in this area
- integrated and real-time online capabilities are not currently well developed with aftermarket suppliers
- suppliers see priority for investment in digital capabilities is to improve customer contact and in data analytics <<





» BUSINESS MODEL DISRUPTION IN THE AFTERMARKET

Based on SAP's observation in the automotive aftermarket, it envisions a number of key driving forces which will grow increasingly more important in the next 3-5 years.

- Increasing velocity of M&A, aftermarket ventures, and joint venture activities.
- Increasing consolidation of the aftermarket value chain, shown by:
 - Federal-Mogul wins its proxy battle to acquire Pep Boys
 - Michelin acquiring Blackcircles and a 40 percent stake in Allopneus
 - Parts makers moving into direct aftermarket and even parts as a service model (PAAS) particularly for fleets, similar to industrial machinery parts
- New business models reshaping the industry, with examples as:
 - Goodyear offering direct fulfillment
 - Direct digital engagement with end consumer by service aggregators
 - Changing online consumer behavior ("Do It Yourself" and "Do It For Me" morph to "Help Me Do It Myself")

One of the most comprehensive business model projects in the aftermarket is at Federal-Mogul. Recently, it acquired the Pep Boys retail operations as well as the Auto Plus wholesale distribution business. The Motorparts division of Federal-Mogul has opened a network of field technical training centers, supported by a technician rewards program. In addition, the company rolled out its new website, which included a platform enabling both installers supporting the Do It For Me (DIFM) market but also the Do It Yourself (DIY) end consumer, with a robust set of configure-price quote (CPQ) and order management functionality.

Federal-Mogul serves as an example of how aftermarket players are exploring brick and mortar as well as digital channels to engage its end market. With large pass-through margins for each step of the aftermarket value chain in play, it's likely that aftermarket suppliers will continue to explore new approaches to engage the end consumer and shop technicians in the independent aftermarket segment.

Key Takeaways

- After years of focus on the consolidation of the distribution channels, the aftermarket industry model itself is now beginning to evolve.
- Over the long term, in-vehicle technology will have a profound impact on the aftermarket industry; meanwhile digital and business model changes are impacting suppliers more immediately.
- Digital capabilities and online customer relationships are changing traditional business practices and the IT systems that support them.
- AASA and SAP have partnered to help suppliers understand these disruptions and identify opportunities for addressing the changes with new capabilities. The first step was a Supplier Business Practices Survey, which indicates that:
 - Suppliers are moving toward enhanced business connectivity with service shop and consumer end-users;
 - There are gaps in the capabilities suppliers need in supply chain execution;
 - Suppliers need integrated, real-time web solutions for customers and enhancements in data analytics.
- Aftermarket suppliers are pursuing new capabilities both to improve execution and to digitize their business processes. «

