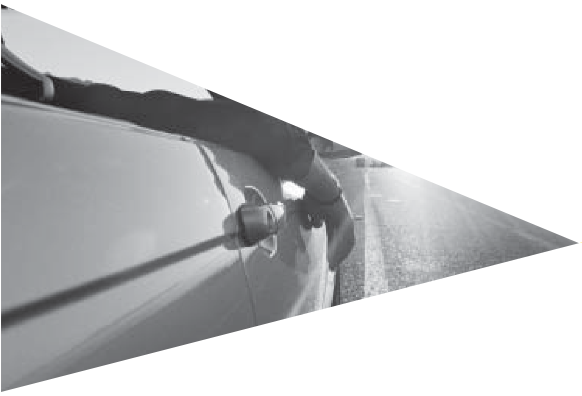
The competitive dynamics in the automotive aftermarket: branded products and private label products



The business case

Throughout the automotive aftermarket industry, senior executives are facing the reality of private brands. Similar dynamics exist outside of the automotive aftermarket and are intensifying in other sectors, such as traditional consumer goods. Also known as "private label" and referred to across many consumer-oriented industries as "store brands," "control brands" or "own brands," their rising prominence has led top executives to ask:

- What issues and risks do US-branded manufacturers face with respect to private brands?
- How are market forces different today than in years past? How will this landscape evolve?
- How can I better understand my operational blind spots in an increasingly competitive landscape?
- What can my management team focus on to protect and grow my brands? Where do we start?
- What are the similarities and differences between the private brand trends in the automotive aftermarket and the consumer products sector?
- What can be learned by automotive aftermarket executives from the private brand experiences in other sectors?

Although answers to these questions are not simple and some market dynamics are not yet fully clear, the availability of private brands and other competitive trends are growing in the automotive aftermarket community, just as they are in many consumer product segments.

One out of every three consumer products sold by one of the nation's largest retailers is now private brand – up from one out of every five just a few years ago. With US private brand sales in the grocery market surpassing well over $80 billion, for example, private brands can no longer be ignored by consumer product manufacturers. The US market share of private brands in food, drug and mass merchant channels is more than 20 percent, according to industry data research firms. More than 80 percent of consumers shopping in big box, warehouse clubs and superstores frequently buy store brands and, depending on the specific product category, multiple store brands at a time. Retailers are focusing more resources on private branding to enhance margins, increase shelf velocity and expand store loyalty and traffic.

Private branding in food, drug and mass merchant consumer products channels is not a new phenomenon, nor is it a new concept in the automotive aftermarket. However, there are differences in the degree to which private brand penetration has occurred in traditional consumer goods industries compared with the automotive aftermarket. The factors giving rise to these differences include the nature and use of the products (e.g., immediate consumption vs.durable goods), the ability of the consumer to exercise preference at point of sale, technological or other barriers to entry for alternative manufacturers to produce private brands, the degree to which products are subject to regulatory controls, and the differences in the channels in which the products are distributed. Notwithstanding these distinctions, private branding will continue to impact the competitive landscape.
Consumer behavior has gone through a dramatic evolution in the past five years, with the economic shifts and downturns, and with the exploding access to information and technology. The lines of consumer priorities are blurring and shifting, and regardless of brand or product mix, measurement and management of these shifts will be the key to strategic success and growth in a global marketplace.

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The US automotive aftermarket is one of the single largest markets in the US and is increasingly affected by private brand influences similar to other consumer product markets. However, total private brand penetration in the aftermarket is not as closely measured and monitored as in other consumer sectors. As brand and product strategies continue to evolve among aftermarket channel participants, more sophisticated measurements of private brand penetration rates are beginning to take root.

Issues, opportunities and risks

According to the AASA Q4 2009 Aftermarket Supplier Barometer report, the degree of market consolidation among retailers is believed to be one of the influences at work in driving increased private brand market share penetration.

Increased retail consolidation can create economy-of-scale advantages for private brands, allowing brand development and deployment costs to be spread incrementally across higher product volumes, decreasing their relative per unit volume significance. Further, private brand penetration appears to vary across product categories. Those experiencing a higher degree of "commoditization" (little or no perceived differentiation across brands) have demonstrated higher private brand market share levels compared to product categories with low degrees of commoditization. Within the automotive aftermarket, product categories such as tires, accessories and maintenance parts are showing similar trends. One recent research report for brake component sales from Frost & Sullivan shows private brands had a 60 percent market share in 2009 and are expected to increase to 66 percent by 2015.

Monitoring private brand market share penetration levels in each aftermarket product category where a branded manufacturer participates can help assess the current degree of commoditization. However, detailed and accurate data regarding private brand penetration levels within many aftermarket product categories are not readily available — unlike other consumables sectors, where scanner-level data from IRI and Nielsen offers good visibility. Private brand penetration varies by type of product category, geography, channel partners and consumer segment. Having more data and measurements regarding private brand penetration, consumer behavior and supply chain visibility will be essential moving forward, in order to respond to opportunities and risks and sustain a competitive advantage.

Understanding customer and consumer segments: private brand preferences

Demographic and ethnographic segment patterns matter. More than 50 percent of 18- to 34-year-olds buy more than half of their consumer staples from private brands. Attitudinal segmentation —similar attitudes and values such as degree of importance placed on the dealer or repair professional, parts availability, do-it-yourself (DIY) considerations, price sensitivity and convenience, shared across segments — can show varying degrees of influence on private brand choices. Understanding customer and consumer decisions across the entire value chain from manufacturer to ultimate consumer will enable better tailoring of brand positioning and more effective promotional programs.

Knowing your customers, where they purchase and what drives their purchase decisions is paramount. In March 2010, Ernst & Young conducted a survey of more than 1,000 consumers and discovered:

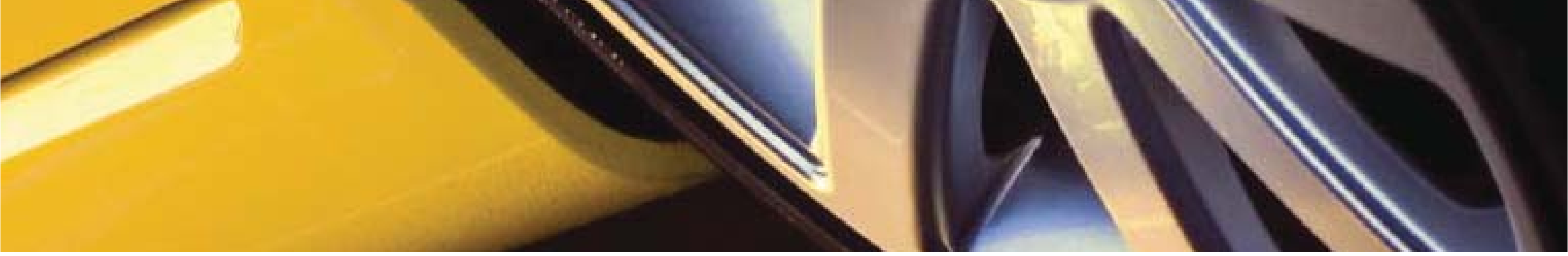
- 56 percent of consumers surveyed purchased vehicle parts and accessories in general automotive repair shops, parts and accessories stores, or chains;
- 22 percent purchased them from new and used vehicle dealers;
- 15 percent purchased them from big box, warehouse clubs and superstores (non-automotive);
- 7 percent purchased them online; and
- 20 percent also serviced their vehicle themselves (maintenance, repair, customization).

Private brand market dynamics are impacting aftermarket channels through which the majority of products are sold. Developing a unique value proposition for each consumer and channel segment based on channel customer influences will be paramount in maintaining market share.

Understanding consumer defection rates (velocity, magnitude and motivations) from major brands to store brands within a product category can be an excellent gauge of brand relevancy in the eyes of a brand's user base.

Figure 1: Evaluating private brand competitive dynamics

Pricing	Quality	Promotion	Distribution & Merchandising	Marketing & Packaging perceptions	Organization
▸ Tiered pricing schemes ▸ Aggressive negotiation with ALL manufacturers ▸ Loyalty programs	▸ Increased quality ▸ Premium private brands	▸ Faster imitation of brands ▸ Moving beyond imitation	▸ Rationalization of manufacturer brand SKUs ▸ Licensing private brands ▸ New product segments for private brand ▸ Novel product placement	▸ Increased branding ▸ Refined aesthetics and advertising ▸ Strategic marketing	▸ Restructuring around private brand programs ▸ Investment in private brand facilities ▸ Aggressively recruiting CPG talent



The automotive aftermarket is experiencing low brand awareness in certain product categories. For select manufacturers, this implies that the risk of becoming a commodity and facing more margin and sales pressures is influenced by degree of brand loyalty across shoppers. Retailers with DIY or do-it-for-me (DIFM) shopper advocacy programs focusing on serving repair professionals can create brand loyalty among their consumers for store-branded products using their reputation as a technical services-oriented supplier of parts. Manufacturers also are trying to get closer to their primary and secondary consumers and raise brand awareness through techniques such as professional installer training programs and advertising campaigns. These special offers are designed to reinforce the message that longer-lasting, better-performing replacement products are today's best quality and are a longer-term affordability option for consumers. According to recent Nielsen Co. data on consumer trends, a key piece of data to keep in mind when considering consumer behavior trends for 2010 is "value messaging must include differentiation beyond pricing for consumers."

Retail engagement: keeping advocates and influencers

Repair professional recommendations and influences on consumer choice are important dimensions in the private brand or name brand success equation. According to a January 2010 Frost & Sullivan report, vehicle owners will adopt repair professional recommendations for batteries up to one-third of the time. The important question to ask is: What are the key influences the repair professionals look at when making brand decisions? It is important to recognize that all participants in the supply channel influence the repair professional's choice.

New and used vehicle dealers, accessory stores or auto parts chains, big box, warehouse clubs and superstores, online providers and search partners all play an increasingly important role in affecting consumer choices. Big box, warehouse clubs and superstores are concentrating on improving the shopper experience by offering a wider selection of private brand offerings in many consumer durables and non-durables.

Implications for automotive aftermarket leaders: understanding operational blind spots

Typically, branded manufacturers and retailers focus only on price gaps and performance gaps, but that may be shortsighted in an increasingly multi-dimensional competitive game. Ernst & Young's professionals believe there are at least six dimensions or strategic levers — both quantitative and qualitative — that manufacturers and retail channel players should identify to understand, measure and evaluate private brand competitive dynamics. These six dimensions (pricing, quality, promotion, distribution and merchandising, marketing and packaging perception and organization) are outlined in Figure 1 on the previous page.

Which of these six are the most relevant to the automotive aftermarket? In many consumer goods product categories, consumers often perceive the quality of private brands as being equal to name brands. But a recent report from The NPD Group, a leading market research company, suggests this isn't always the case with consumers of automotive aftermarket products. According to NPD, some automotive aftermarket consumers still perceive a quality difference between private brand and name brands. In the category of motor oil, NPD suggests that more than half of consumers surveyed believe motor oil name brands are of better quality than store brands, while nearly one-third see no real difference. What quality level is each consumer market segment willing to pay a premium for?

Manufacturers need to understand where their customers stand on quality vs. price, and must clearly differentiate those attributes that will best drive purchase choice behavior. Likewise, retailers should evaluate brand assortment to ensure they are meeting the requirements of both quality- and value-driven consumers. It is a fact that in some cases, repair shops may utilize original equipment parts over aftermarket or private brand parts. Retailers and warehouse distributors may utilize private brands to promote their reputation as more economical in the short run. The key question to ask is: Keeping safety, dependability and performance in mind, what is the true risk/benefit ratio perceived by consumer segments where each aftermarket product category sells and what levels of price portfolio are fair? Remember, it is the consumers who pay, and depending on whether it is a repair or maintenance issue, they wield more power today than ever.

Safety, dependability and performance are of utmost importance to the vehicle owner/consumer when it comes to automotive aftermarket parts used for vehicle maintenance and repairs. As participants in the aftermarket distribution channel (including manufacturer, distributor, chain or independent retailer and repair professional) seek to respond to and influence consumer choice, build trust and maintain market share in vehicle repair and replacement, all players must understand how the products they offer meet these key consumer values and support their reputation in the market.

AASA has launched an initiative called "Know Your Parts," designed to encourage all distribution channel participants to fully evaluate the increasing number of competing products in the marketplace across several dimensions of dependability, quality and performance. This campaign highlights the importance in understanding the extent to which there is transparency in the manufacturer's commitment to provide support in the form of technical specifications, warranty, quality assurance, training and other services. It recognizes the important role that repair professionals, distributors and retailers play in influencing customer and consumer choice, particularly when the consumer is more dependent on the supply chain for information to support choice decisions among complex products.

Protecting and growing brands

Both manufacturers and retailers are asking for clarity in how to understand and act upon private brand market dynamics. We suggest they begin by asking the following questions:

1). Learn the market: See reality in customer and consumer perspectives

- What levels of awareness, consideration, purchase intent, usage and loyalty exist within the categories and brands where I compete?
- How is the market changing, and how will future consolidation create opportunities?
- Are we using digital and social media resources to gain specific insight into consumers?
- Should we establish strategic listening posts using social media as an ongoing program rather than a one-time effort? Where along the distribution channel should such measures be used?

2). Know thyself: Look at what value your brands offer in each product category and consumer and repair professional segments

- How can my management teams think differently rather than preserve the status quo?
- Should organizational practices or structure change in light of private brand dynamics?
- Which brands represent leading practices that should be replicated?
- What marketing and promotional levers can be pulled to preserve and grow brand loyalty and quality perceptions among all distribution channel consumers?

3). Evaluate new competition

- Where are my marketing activities over- or under resourced as compared to competitors? Does this new reality offer cost-reduction or revenue opportunities? b). What is the potential to maximize revenues given the price elasticity of my products as compared to competitor and private brand offerings?
- How are competitors combating private brand threats, and what lessons can be learned?
- Which competitors' brands represent an opportunity for acquisition to gain market power against private brands?

4). Build private brand defense and offense strategies and competencies

- How can I build a private brand monitoring capability?
- Should I develop a private brand index or similar measure?

Aftermarket companies need to develop holistic, reliable and multidimensional measures to better understand, evaluate and monitor private brand value gaps across the entire aftermarket distribution channel. These measures must go beyond pricing and include quality, innovation and other dimensions such as customer and consumer perceptions. Obtaining information to develop such measures will likely mean using different approaches to gather consumer-level insights. This analysis focuses on three areas: 1) measuring and evaluating the true penetration of private brands within various product categories experiencing a high degree of commoditization, 2) identifying the root causes of this trend in quantitative and qualitative terms and 3) building viable and practical responses at brand and category levels.

Contacts

John Buggie
Customer Advisory Leader
John.Buggie@ey.com
+1 215 448 4157

Jeff Henning
Global Automotive Markets Leader
Jeff.Henning@ey.com
+1 313 628 8270

Regan Grant
Global Automotive Center Marketing
Regan.Grant@ey.com
+1 313 628 8974

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