

The changing aftermarket game – and how automotive suppliers can benefit from arising opportunities

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¹ Founded in 1959 and based in Brussels, CLEPA (Comité de liaison européen des fabricants d'équipements et de pièces automobiles) members include more than 100 of the world's most prominent suppliers for car parts, systems, and modules along with national trade associations and European sector associations.

Executive summary

A host of geographical and technological developments is expected to disrupt the automotive aftermarket over the next 5 to 10 years. To develop a holistic view on the industry, assess aftermarket trends and their potential impact – on the “balance of power” and the “bottom line” – and derive implications for automotive suppliers, McKinsey conducted a course of research that included a survey of CLEPA members, in-depth interviews with industry experts, and a review of insights from our global network of experts and executives within the automotive aftermarket.

Overall, we find that the global aftermarket industry is expected to grow at a rate of 3% p.a. through 2030, but the shape of that growth is likely to change in three important ways:

- **Region.** China will become the primary driver at 8.1% p.a. with the rest of Asia at 6.5%, while Europe and North America will contribute modestly at around 1.5%.
- **Business model.** A shift towards proprietary channels and partnerships, in particular via e-commerce businesses and workshops, is expected.
- **Products and services.** Services and diagnostics are expected to grow about 3 percentage points faster than wear-and-tear and crash-relevant parts. Digital-related revenues will triple to a share in sales of almost 20%.

For automotive suppliers, in particular, six top trends are expected to change the way the aftermarket game is played:

1. Consolidation among parts distributors
2. Aggressive expansion of OEMs into aftermarket activities
3. Digitization of channels and interfaces
4. Access to car-generated data
5. Increasing influence of (digital) intermediaries
6. Higher price transparency and greater diversity of supply for customers.

Despite all evidence of the disruptive nature of these aftermarket trends – manifesting itself, for example, in their impact on revenue, profitability, and industry structure – 80% of players say they are currently not well prepared – mainly due to a lack of strategic focus and skills and insufficient digitization resources.

The ultimate impact of these market phenomena on suppliers' profitability will depend on how well they can minimize their negative impact and capitalize on the chances they present. To come out ahead and benefit from arising opportunities, automotive suppliers will need to assess the likely impact of these disruptive trends on their business.

Specifically, suppliers will need to understand the most probable future industry scenarios – ones in which multiple player categories are likely to benefit or, in more extreme cases, ones in which one player type, such as OEMs or distributors, can be expected to dominate the aftermarket landscape. They will then need to create a path for themselves that considers their strategic aspirations, the shape of their presence in the market, their partnerships and position within the value chain, and the tools that enable and deepen their relationships with their customers.

Introduction

The automotive aftermarket is undergoing dramatic changes with evolving customer expectations, acceleration of technological innovation, and shifts in competitive power. These changes will reshape the way customers, automotive suppliers, and other aftermarket companies think of cars and driving and how business in the automotive aftermarket is conducted and value is created.

Moreover, the emerging markets will create new needs and pressure to act for the aftermarket industry. At the same time, its players will face challenges from the increasing pace of industry consolidation, especially in North America and Europe. In addition, players such as automotive suppliers that have long conducted business in a relatively stable environment will face a new type of competitive pressure from players at different stages of the aftermarket value chain as well as new players with, for example, digital-driven business models.

New technologies and major shifts in the aftermarket industry will be game-changing factors that all players have to react to now in order to maintain strong positions in the future. As many industry experts agree that significant changes are ahead, McKinsey has undertaken the effort of creating a big picture of the most relevant trends disrupting the European aftermarket from an automotive suppliers' perspective and ideas for how to face them.

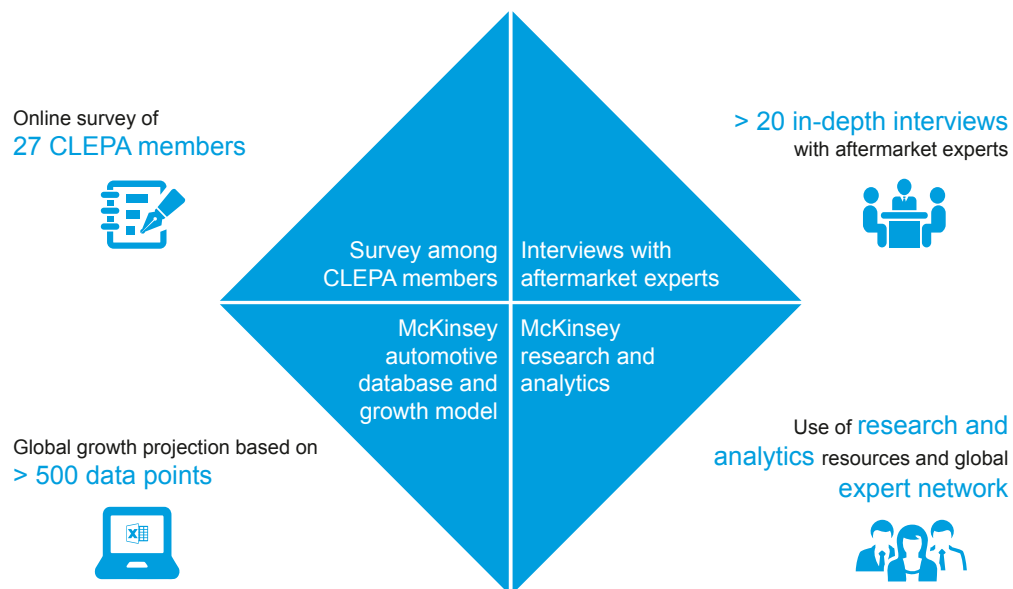
In order to be successful in the new aftermarket game, automotive suppliers need to take action now. This starts with an assessment of the trends' impact on their individual organization and defining the future strategy along ten strategic and operational core dimensions.

In this report, McKinsey aims to illuminate the changing aftermarket game and provide answers to the following key questions from the perspective of automotive suppliers in Europe:

- What is the current setup of the automotive aftermarket, and what is its (growth) trajectory through 2030?
- Which trends will impact the aftermarket and how might the resulting strategic moves of the players involved change the game?
- How can automotive suppliers take full advantage of the expected changes and capture the resulting new opportunities?

In discussing these questions, the report presents a logical sequel to our 2016 publication (cf. Dirk Breitschwerdt, Andreas Cornet, Lukas Michor, Nicolai Müller, Lionel Salmon, "Performance and disruption – A perspective on the automotive supplier landscape and major technology trends", McKinsey, March 2016) with its targeted focus on the automotive supplier landscape and the major technology trends impacting it.

Exhibit 1 Data from a variety of sources was gathered to develop and present the latest insights



SOURCE: McKinsey

Methodologically, we rely on our various project experiences, an online survey among approximately 30 CLEPA members, in-depth interviews with aftermarket experts, a global growth projection, and insights from our global network of experts and executives within the automotive aftermarket (Exhibit 1).

1

The growth outlook for the after-market is stable, although the market structure will change significantly



The structure of the automotive aftermarket

The aftermarket is the part of the automotive industry sector comprising the automotive services and parts businesses. The service business (maintenance and repair of vehicles) generates about 45% of total aftermarket revenues in Europe, while retail and wholesale of vehicle parts make up the remaining around 55%. Together, the two businesses are an important part of the overall automotive industry as they deliver substantial revenue of approximately USD 760 bn globally (2015) or around 20% of total automotive revenues and higher profitability than most of the industry's other subsectors.

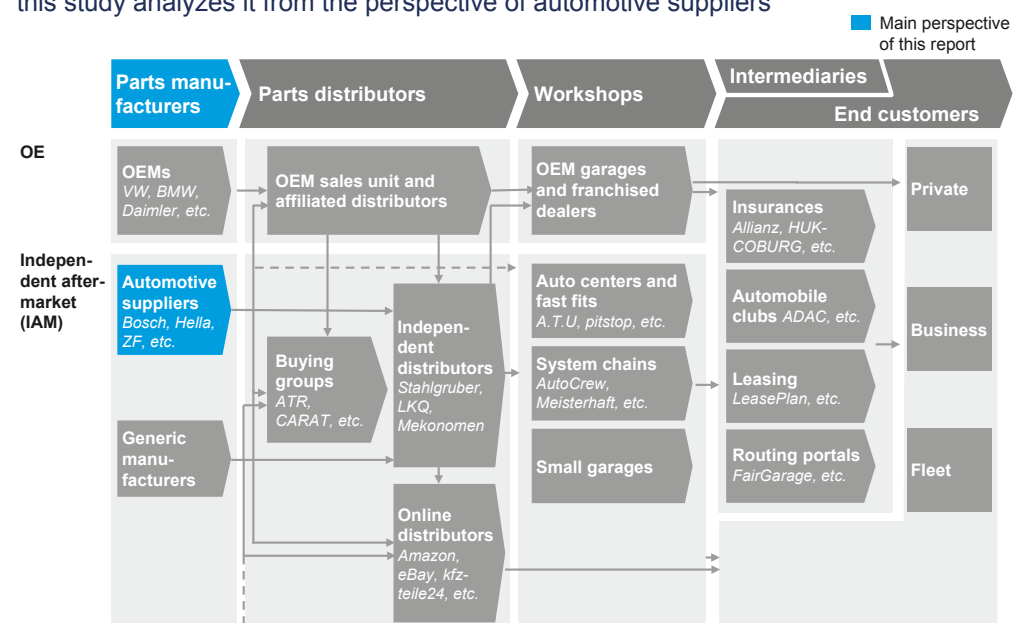
“Intelligent and innovative solutions from automotive suppliers are an important driver for safe, smart, and sustainable mobility.”

Sigrid de Vries, CLEPA

When it comes to the stakeholders, the aftermarket is generally split into the OEM network and the independent aftermarket (IAM). Along the value chain, multiple types of stakeholders interact with each other. Market structure and the degree of consolidation vary across regions. And, while players' levels of power along the value chain also vary by geography, five distinct stakeholder groups consistently make up the automotive aftermarket (Exhibit 2):

- **Parts manufacturers** such as OEMs, automotive suppliers, and generic manufacturers that produce aftermarket parts and offer services
- **Parts distributors**, including buying groups, independent distributors, online retailers, and OEMs with their affiliated distributor network
- **Workshops**, including the OEM workshop networks, auto centers, system chains, and small garages
- **Intermediaries**, in particular insurances, automobile clubs, leasing companies, and routing portals
- **End customers**, consisting of the private, business, and fleet market.

Exhibit 2 The aftermarket is made up of 5 stakeholder groups and 2 supplier models; this study analyzes it from the perspective of automotive suppliers



SOURCE: McKinsey

Market size and the global growth outlook

McKinsey's proprietary modeling of the automotive aftermarket was developed to project growth of the global industry. The model represents values at the end-customer price level, including parts, labor, maintenance, and crash-relevant revenues, with a granular differentiation by region. It imputes a total global value for the market in 2015 of approximately USD 760 bn. More granularly, three regions accounted for over 75% of this value: more than a third came from North America (35% or approximately USD 267 bn), Europe was second with approximately USD 237 bn (31%), and China's approximately USD 72 bn market accounted for 10% of global value.

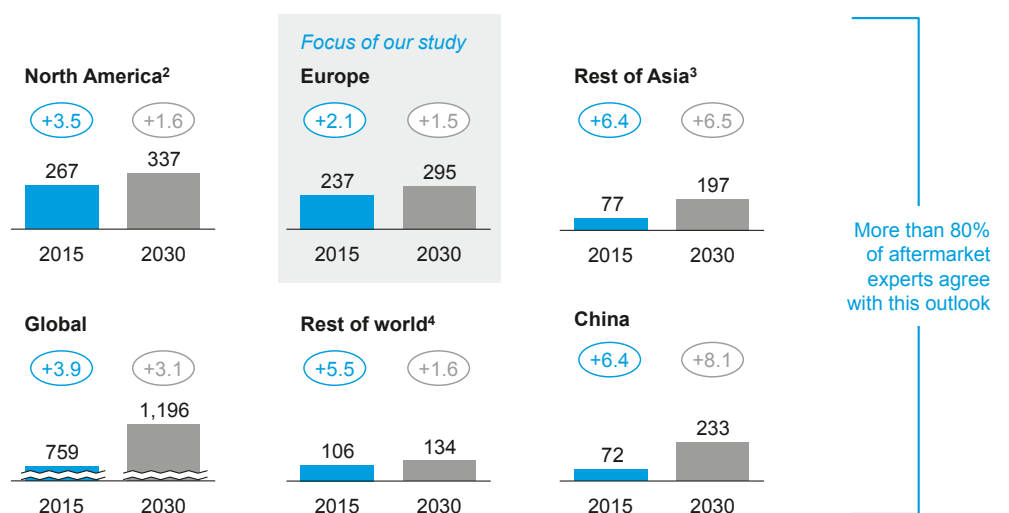
In the past five years, the overall automotive aftermarket has shown healthy growth and profitability. We expect this trend to continue and that the aftermarket will increase to approximately EUR 1,200 bn by 2030 with an underlying global growth rate of roughly 3% p.a. This means a slight decrease of almost 1 percentage point from past growth rates. Interestingly, we expect shifts in sources of growth, in particular in terms of region, business model, and product and services groups.

Region

Growth will not be evenly distributed by region with significant differences between consolidated markets and emerging markets (Exhibit 3). Largely fueled by China, Asia will be the driver for growth in the global market in the coming years. With the country's booming economy behind the climbing rate of car ownership, it is expected that China will approach the light vehicle population of Europe by 2020 and account for about a fifth of the USD 1,196 bn global automotive aftermarket in 2030. In particular, the service market will grow strongly in China, mainly due to the growing average age of the vehicle population. While the average vehicle age in China is currently comparatively young at about 4.5 years, it is expected to increase significantly and

Exhibit 3 After a period of high growth, revenues in Europe and North America are expected to almost stagnate, while Asia's will increase significantly

Total aftermarket revenues in USD bn¹



¹ Including parts, labor, maintenance, and crash-related revenues

² Including the US, Canada, and Mexico; ³ Including India; ⁴ Including South America, Africa, and Oceania

SOURCE: McKinsey market model; expert survey among CLEPA members (n = 27; February 2017)

soon. However, the speed of growth in Asia is expected to slow down in the future, largely due to a general slowdown of China's economic growth in the next years.

At the same time, we see only moderate growth in the automotive aftermarket for mature markets despite increasing vehicle densities. In the consolidated markets of Europe and North America, growth rates of the vehicle population over the last 10 years were below 2% p.a. At the same time, the average car age increased from 10.5 years to 11.5 in the US and from 8.4 years to 9.7 in Europe. These trends highlight the increasing need to deal with older vehicle segments. Overall, we expect automotive aftermarket revenues of approximately EUR 337 bn in North America and approximately EUR 295 bn in Europe in 2030 – with annual growth rates in both markets around 1.5 % until then.

Business model

Aftermarket business is conducted via several business models, including OE/OES, the independent aftermarket, workshops, and a range of other business models or channels (e.g., e-commerce). While most aftermarket suppliers are currently operating in the independent aftermarket and via the OE/OES channel, we expect that a shift towards direct distribution models and partnerships (in particular e-commerce businesses and workshops) will characterize the evolution of the aftermarket. Currently, only about one in three players is using either of the latter two business models, but many experts predict that these will become more important in the near future.

Products and services

On the product side, aftermarket executives indicated that currently about half of revenues comes from wear-and-tear parts, followed by crash-relevant parts, diagnostics products, services, and other parts. Going forward, it is expected that the growth of wear-and-tear parts will slow down due to increasing part quality, e-mobility, and price pressure. Similarly, crash rates will decrease as a result of enhanced safety. Although the higher use of sensors might increase the average cost of each single crash, in sum a decrease is expected. Instead, growth will come from diagnostics and services as new offerings emerge, many of which are linked to digitization and car data. Growth rates of the latter are expected to be approximately 3 percentage points above the average for the aftermarket as a whole.

“Of course the aftermarket industry is going digital. We will see many new products and services that will emerge in the near future, giving rise to new business models. But it will be a challenge to stay ahead of the game.”

Michael Soeding, Schaeffler

Also, digital-driven products and services will account for a growing share of overall value (Exhibit 4). It is expected that their share of aftermarket revenue will increase by a factor of 3, from currently 6% to almost 20% within the next 10 years. Growth in these digital offerings will come from hardware (e.g., telematics devices, sensors, or displays), software (e.g., vehicle tracking, total cost of ownership, or driver monitoring software), and services (e.g., fleet management, theft protection, or over-the-air update services). In many cases it will be new players who use digital to offer these new solutions.

Exhibit 4 Wear-and-tear parts currently represent the largest share of suppliers' aftermarket revenues, but services and diagnostics products are expected to drive growth

	Current AM revenue share Percent	Growth vs. avg. AM ²	Rationale (examples)
 Wear-and-tear parts	53	= 0 pp	Part quality is getting better, but average vehicle age is increasing Price pressure from Asian manufacturers
 Crash-relevant parts	12	↓ -1 pp	Enhanced car and road safety will decrease crash rates
 Services	6	↑ +3 pp	New services are emerging, e.g., fleet management and digitally-enabled services
 Diagnostics products	9	↑ +3 pp	Car data and new technologies give rise to "Diagnostics 2.0" (a new market that might be captured by OEMs)
Other ¹	20		

¹ Including engines, drivelines/powertrains, turbos

² Expected revenue growth of segment vs. average total aftermarket in the next 10 years

SOURCE: Expert survey among CLEPA members (n = 27; February 2017); expert interviews with 20 aftermarket experts

A few disruptive trends, however, will have strong and opposing influences (as well as rather complex compound effects) on the development of this market and the distribution across players. To provide further guidance on why specific trends will have a high impact and precisely how these trends can be factored into the market trajectory and the strategy planning of players (above all automotive suppliers), we discuss the changing aftermarket game in the following section.

2

Several global trends can be expected to disrupt the current aftermarket game



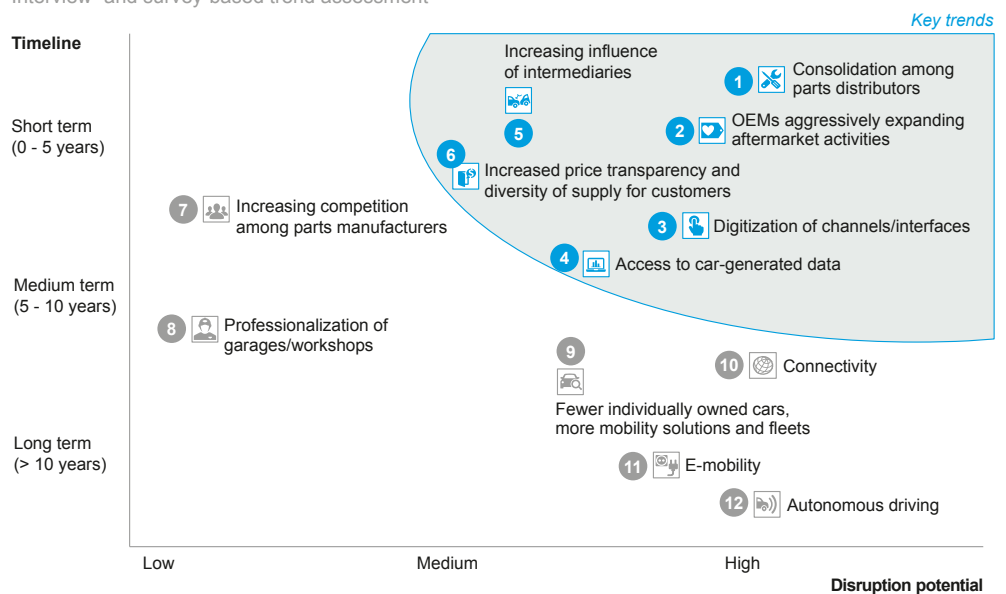
The automotive aftermarket industry as a whole is affected by several major disruptions, in particular digitization, shifting competitive dynamics, and changing consumer preferences. Looking at digitization, for instance, the use of smartphones has enabled new mobility services such as e-hailing while a substantial share of car-related information search and purchases has moved online. In terms of the changing shape of competition, two dynamics are emerging alongside the consolidation of parts distributors and other trends that have been visible for some time now. First, new players are beginning to enter the automotive market and established companies have been changing their business models – a trend that will continue in the future. When it comes to consumer preferences, young generations are less interested in car ownership while stricter regulations on emissions are giving rise to electric vehicles.

By conducting broad analyses based on industry data and complementing the results with insights from leading aftermarket experts, McKinsey identified 12 aftermarket-specific trends that can be expected to significantly impact the industry, especially from the perspective of automotive suppliers. Together with experts and members of CLEPA, we then ranked those 12 trends by impact using two dimensions:

- **Timeline** – assessing how imminent the impact of a trend is likely to be, i.e., either short term (within 5 years), medium term (in 5 to 10 years), or long term (above 10 years)
- **Disruption potential** – sizing the trend’s impact on revenue, profitability, and industry structure (Exhibit 5).

Exhibit 5 Experts believe that 6 trends specific to automotive suppliers have a high potential for disruption in the next 5 - 10 years

Interview- and survey-based trend assessment



SOURCE: Expert survey among CLEPA members (n = 27; February 2017), expert interviews with 20 aftermarket experts; McKinsey

Of the twelve, 6 trends – consolidation, OEM expansion, digitization, data, intermediaries, and transparency – will have the biggest disruptive impact in the next 5 to 10 years. Depending on the region, market segment, and players, however, these trends may vary in their manifestation and importance.

“While autonomous driving and electrification receive nearly daily press attention, the most considerable game changer for the aftermarket will be connectivity and data-based business models. It is happening now and it is developing fast.”

Frank Schlehuber, CLEPA

In the following, we first describe these six aftermarket trends and discuss their effect on revenue and profitability of the aftermarket’s key players as well as on the market structure. Against this backdrop we then introduce three aftermarket scenarios that help us evaluate the implications of a complex set of potential strategic moves and illustrate the wide range of potential outcomes.

The top 6 disruptive trends and what they mean for automotive suppliers

1. Consolidation among parts distributors

As the aftermarket continues to mature, more consolidation can be expected. Among the various aftermarket players, the highest pressure for consolidation currently is on the parts distributors that need to reach critical mass and leverage economies of scale (e.g., size of customer access and purchasing volume).

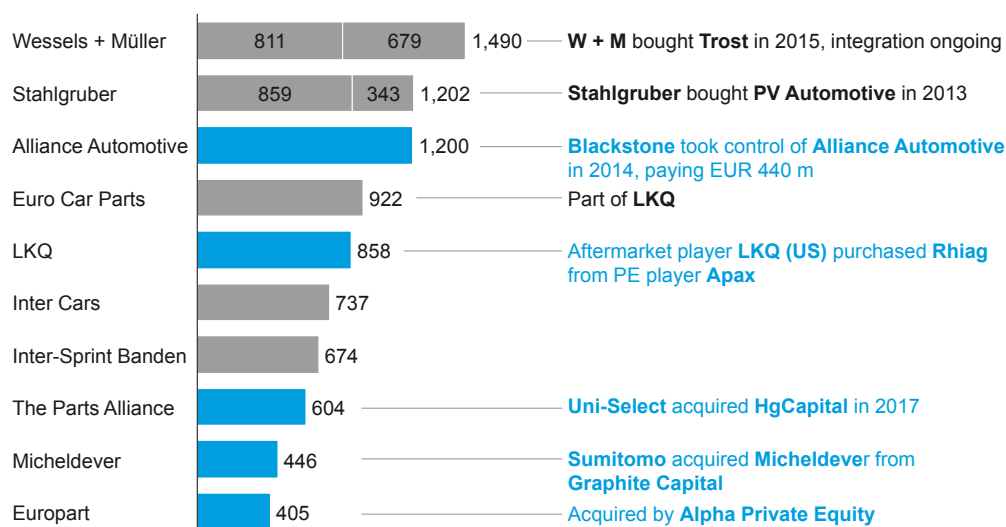
By contrast, automotive aftermarket players are taking various consolidation-related actions to secure and further expand their positions in the aftermarket. Parts distributors as well as buying groups are pursuing M&A to increase their size and establish an international footprint.

Exhibit 6 The wholesale landscape in Europe has changed due to several M&A activities, including those of private equity players

Sales¹ of largest auto parts distributors in Europe

EUR millions

■ PE involvement



¹ As of 2015 or latest available FY, partly estimates

SOURCE: Orbis; company accounts; press; McKinsey

We expect that the degree of consolidation in Europe will follow in the footsteps of the US market, where the top 4 wholesalers already have a market share of around 40%. In fact, consolidation in Europe has already started. Just in the last few years, the European parts distribution landscape saw major transactions, for instance, the acquisition of Trost by Wessels + Müller in 2015. Also, there has been a strong push by private equity (PE) companies into the aftermarket (Exhibit 6). As of now, PE players have invested in 5 of the top 10 distributors in Europe, including Alliance Automotive, Euro Car Parts, and Rhiag. In addition, North American wholesalers aggressively seek growth opportunities in Europe, what will likely spur further consolidation in the industry. While Chicago-based LKQ has been investing for years in European parts distributors, Canadian Uni-Select Inc. has just recently started expanding into Europe with its acquisition of The Parts Alliance in the UK.

2. OEMs aggressively expanding their aftermarket activities

As the age of vehicles is increasing, OEMs' aftermarket business has gotten more and more under pressure because their aftermarket market share in older age segments drastically decreases and other players claim their piece of the pie. While more than 50% of the US passenger cars younger than two years are serviced in the OEM network, this number decreases to around 15% for vehicles older than eight years. For OEMs in emerging markets, the numbers are even tougher due to higher average vehicle age.

Although the aftermarket has been one of the strategic focus areas of many OEMs for a few years now, the level of activity and focus on the aftermarket has increased recently. Some OEMs are starting to solidly occupy one or more spaces within the aftermarket value chain by, for example, creating their own networks of non-car brand-specific repair shops (see Text box). Others are responding to vehicle age-driven market share declines by introducing second service formats and second brands (e.g., VW Direkt Express) or remanufactured parts to compete with independent players and keep customers in their network longer. OEMs are also investing in customer experience optimization efforts and introducing differentiated service offerings by, for example, leveraging vehicle connectivity to "loyalize" their customers and "automate" decision making related to service and repair.

Targeting the full aftermarket value chain: the example of PSA

A recent example of an OEM's strategic focus on the aftermarket is PSA. The French carmaker is moving boldly into the (independent) automotive aftermarket, making it a significant part of its "Push to Pass" five-year growth strategy.

In addition to a series of acquisitions, PSA has launched several of its own brands along the entire value chain. The carmaker has stakes in the distribution game with the brands Distrigo and Mister Auto and established itself as a brand-agnostic workshop chain with Euro Repar. What's more, with Aramisauto and Autobutler the French company is also active in the aftermarket intermediaries space.

Through this holistic approach, PSA wants to target all consumers, regardless of their vehicle brand, age, or distribution channel. While PSA is still the leading OEM when it comes to expanding aftermarket activities, other OEMs – both volume and premium players – have started to follow its example, given the attractiveness of the industry.

3. Digitization of channels and interfaces

Digital channels will gain increasing influence in customers' research and purchase processes – in developed as well as in emerging markets. Customers turn to online communities and reviews, among other digital platforms, as a way to improve their purchasing decisions. Multiple platforms for online parts sales exist already. Suppliers, OEMs, distributors, and workshop chains will continue to increase their online participation and launch new platforms. We expect that the e-commerce share of parts sales will increase to 20 to 30% by 2035, a level at which it is likely to plateau. By contrast, logistically demanding parts, e.g., windshields and airbags, which are difficult to transport or part of complex workshop processes, will continue mainly being sold via the traditional OEM or IAM wholesale channels.

Digital will allow aftermarket players to further increase the automotive aftermarket's value as connectivity helps them move closer to the end customer and generate big data. However, with the car becoming a platform for software and applications, profit might shift to tech giants or new software entrants. Traditional parts manufacturers, distributors, and workshops potentially come under pressure as OEMs, intermediaries, and online providers may attempt to increase their influence on end customers, shrinking the margins of players accustomed to having the full attention of end customers.

“Digitization allows for substantial improvements in the value chain and decreasing lead times for workshops and customers. However, in order to be successful, we as an industry – both suppliers and distributors – have to work together.”

Dr. Andreas Habeck, Hella

On the other hand, given the shorter value chain as trade steps are omitted, some players have a bullish outlook and expect margins to remain stable or even increase as the margin of distributors and middlemen will be divided among customers, parts manufacturers, and online shops.

In addition, parts distributors and workshops can seize the opportunity and increase their individual market presence through consolidation, collaboration, and professionalization. Intermediaries, who connect customers and services, will create new profit pools and opportunities.

4. Access to car-generated data

A massive wave of new data is cresting. Today's connected vehicle already has about 40 micro-processors and generates 25 GB of data per hour, including telematics and driver behavior data. As processes beyond the car become digitized, additional data will also be captured.

Aftermarket experts expect big data and advanced analytics to become an indispensable asset in the future. Today, however, the general perspective is that most automotive aftermarket players are not adequately prepared to take advantage of the big data opportunity. Those who are able to move quickly and effectively in this space have to differentiate themselves from the competition.

At the intersection of big data and advanced analytics there are several game changing opportunities for suppliers to increase their revenue and/or make their operations more efficient:

- **Deeper customer insights.** To benefit from insights about customer behavior, preferences, and needs, suppliers need to ensure access to customers and the relevant data, either directly (e.g., via technology inside the car or CRM platforms through e-commerce channels) or indirectly (e.g., via partnerships with OEMs, workshops, or intermediaries such as insurers).
- **Operational excellence.** Digitally collecting data on – for example – parts inventory/warehousing and car and fleet activity can help aftermarket players finetune their operations, build customer leads, and boost sales.
- **Response recommendations and readiness.** Breakdown services that call for roadside assistance or recommend service locations are becoming a (legal) standard in many countries. With an integrated, digital supply chain and by partnering up with other players involved (e.g., workshops, insurances, distributors), suppliers are able to provide the right parts or components in time to reduce repair cycles.
- **Predictive maintenance and remote on-board diagnostics.** The continuously sent status data of connected vehicles facilitates an instant analysis and check of the vehicle. This possibility of predictive maintenance also allows for continuous improvement of vehicle operation (beyond planned fixes) and for better distribution of workload in service shops.
- **New digital services.** Connectivity enables a new range of digital services, which can be purchased on demand by customers. Although new players have been entering this field, there is a lot of potential for suppliers, both in hardware and software, for new services.

Connectivity potentially opens the car as a system to aftermarket players. The questions this poses are: who has what kind of access to in-vehicle data and resources and who will own the customer contact in future? The degree to which different players are able to control or have access to the data depends on the future regulatory guidelines. These guidelines still need to be developed and it is still to be determined which data is of proprietary use for a specific player and which can be used by multiple aftermarket players or even has to be made publicly available.

“Car and customer data and the knowledge about how customers act in and around the car is the black gold of the future.”

Marcus Larsson, Mekonomen

5. Increasing influence of (digital) intermediaries

Recently, a variety of new intermediary business models has emerged. On the one hand, established players – such as insurers that have been offering usage-based insurance contracts for years in the US and UK – have started to take advantage of new technologies such as telematics. On the other hand, new players with mainly digitally-linked business models have entered the aftermarket. Providers of telematics solutions and fleet management systems have surfaced in the start-up hubs from Silicon Valley to Tel Aviv, targeting both B2C (e.g., car owner telematics, end-consumer leasing) and B2B (e.g., car sharing fleets, professional logistics) businesses. Against this backdrop, aftermarket experts believe that intermediaries will expand

their value chain footprint and become more powerful in the future given their direct access to customers (both businesses and drivers) and hence to relevant data.

Usage-based insurance, for example, is expected by 2020 to have a market share of 20 to 25% in the US and 15 to 35% in Europe (where we see large differences in adoption rates per country). Another upcoming topic is fleet management, in a business as well as in a customer fleet context. The rise of car sharing users and professional fleets opens up new opportunities to steer and optimize maintenance and repair services. Partnerships will likely emerge between intermediaries and workshop chains, and the workflow and parts logistics can be fully automatized.

“Intermediaries are becoming more important, more influential. On the one hand, established players like insurances are offering new digital services based on telematics. On the other hand, new entrants will offer services that are currently performed by traditional aftermarket companies. By nature, newcomers can ignore traditional market structures and cherry pick on niches or volume.”

Helmut Ernst, ZF

While there is a threat that new players will gain direct customer access, suppliers can enter into partnerships with intermediaries providing high-quality parts and services such as analytics while tapping into large numbers of fleet vehicles and ensuring access to relevant customer and car data.

6. Higher price transparency and greater diversity of supply for customers

Digital channels are gaining increasing influence in customers' research and purchase processes – in developed as well as in emerging markets. The evolution of Internet-empowered, informed customers will likely change the automotive aftermarket in two key ways:

Price transparency. Online channels give customers quick access to information on the prices of parts. Across Germany, France, and the UK, 25 to 30% of end customers evaluate workshops using online channels, and 20 to 30% of end customers use these channels to determine which car parts to buy. Similarly, online forums give customers peer perspectives on the quality/value of workshops. At the moment, digitization of the actual buying process is focused on parts, but online purchasing of services will become more and more important.

For suppliers, the effect of price transparency might mean a decrease in price and greater price transparency through e-commerce and big data might challenge the current margins. E-commerce has already fueled cross-border trade within Europe, resulting in price drops in countries with, formerly, little competition and/or generally high price levels. Additionally, online price comparison provides private brands with opportunities to build on their price advantage over branded products.

Online sales. Currently, traditional distributors dominate sales to workshops: while about 85 to 95% of workshop orders are placed on B2B platforms or physical channels of traditional distributors across analyzed markets, less than 5% of the orders are placed through online specialized players or mass merchandisers in Germany, the UK, and France and only 10 to 15% in Poland and Russia. The e-commerce share of workshop orders via distributor-independent B2B platforms will also continue to rise while the share of workshop orders via the pure physical channels of parts distributors will become less important. By 2035, 20 to 30% of aftermarket sales will be carried out online, a level at which the online share will plateau due, in part, to the fact that online players do not serve installer needs of fast delivery and flexible commercial conditions.

Online could be an opportunity for suppliers to start their own online presence or partner with successful platforms. Some players have already set up their own online channels, e.g., Hella. Finally, a digital sales model may be the key to a shorter, leaner value chain that benefits suppliers. By eliminating the need for intermediaries and streamlining the distributor layer, suppliers may see bigger margins and savings they may decide to pass on to their customers.

Implication of these trends on revenue and profitability of suppliers and the market structure

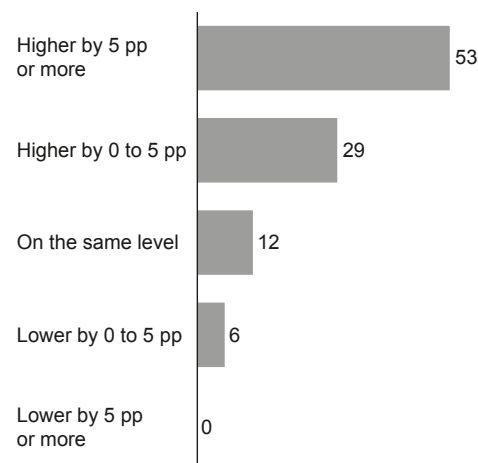
Now, we have a sense of each of the top 6 trends and an understanding of why they have a high potential of disrupting the aftermarket in the short or medium term. As a next step, we want to understand what the potential impact of each trend might be on automotive suppliers' revenue and profits as well as on the aftermarket industry structure.

A majority of aftermarket executives (53%) say that the profitability of their business is very healthy at the moment (Exhibit 7). Looking 10 years down the road, however, more than

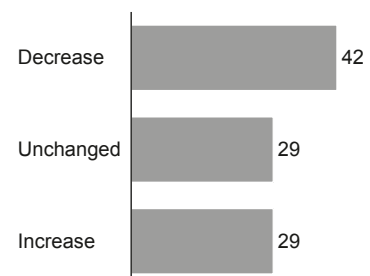
Exhibit 7 The vast majority of experts state that profitability is currently healthy, but 42% expect margins to decline in the future

Percent of responses

How profitable is your aftermarket vs. non-aftermarket business?



How will aftermarket profitability develop within the next 10 years?



SOURCE: Expert survey among CLEPA members (n = 27; February 2017); expert interviews with 20 aftermarket experts

40% expect that this will change for the worse. To investigate this interesting outlook further, we looked into the effect of each of the top 6 trends on the three aspects of disruption: revenues, profitability, and industry structure (Exhibit 8).

Exhibit 8 The 6 top disruptive trends will have a negative impact on automotive suppliers' revenues and profitability, and will cause significant shifts in the industry landscape

Top disruptive trends	Impact from automotive supplier perspective			Market structure ¹
	Revenues	Profitability		
 Consolidation among parts distributors	▬ No effect on size of demand	↓ Distributors are able to push prices by leveraging bargaining power	 Medium	Market power of distributors increases
 OEMs aggressively expanding after-market activities	↓ Revenues from services and diagnostics might be captured by OEMs (for pure IAM players)	↓ OEMs can control many steps in the value chain and push margins	 Medium	OEMs move into IAM and other value chain areas
 Digitization of channels/interfaces	▬ No effect on size of demand	↑ Higher margins due to shorter value chains (direct sales)	 High	Value chain becomes shorter, some players might be cut out
 Access to car-generated data	↑ Car data is crucial to sell existing services and offers potential for new revenues	↑ Incremental revenues with higher margins	 High	New products and services can be offered by all players
 Increasing influence of (digital) intermediaries	▬ No effect on size of demand	↓ Intermediaries are able to push prices by leveraging bargaining power	 Medium	Market power of intermediaries increases via direct access to customers
 Increased price transparency and diversity of supply for customers	▬ No effect on size of demand	↓ Increasing competition and price transparency decrease margins	 Medium	Market power of consumers and intermediaries increases

¹ Indicates shifts in market power across different players or disruption of traditional value chain activities

SOURCE: McKinsey

Looking at **revenues**, the impact of the six trends is rather neutral from the perspective of suppliers. Specifically, the aggressive expansion of OEMs could cause a decrease in volume for suppliers if car manufacturers put a strong focus on competing for services and diagnostics volume and combine these with parts sales. For suppliers that are purely focusing on the independent aftermarket, this could mean a reduction in revenues. Balancing this reduction, new opportunities arise from car data; new revenue-generating services and products are already emerging based on the use of driving and driver data.

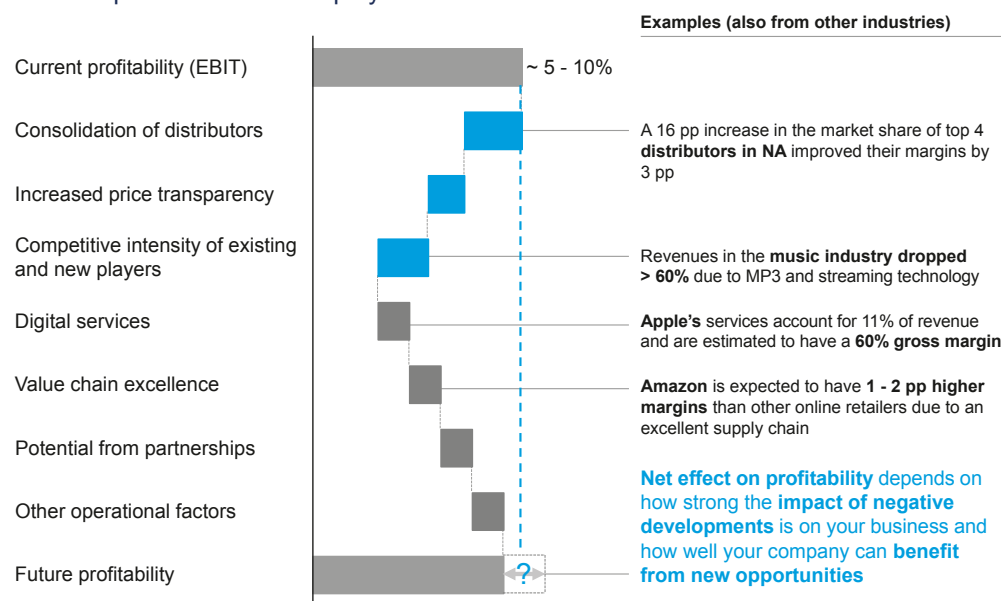
With regard to **profitability** it is expected that digitization of channels and interfaces as well as access to car data will have a positive impact, disrupting the supply chain and bringing in completely new business opportunities. These two trends offer the possibility of new revenue streams that are associated with high margins and are likely to boost profitability for suppliers in the medium term. Services such as remote diagnostics are among the high-margin opportunities that the car-generated data trend presents. Of course, partnerships with new players in various areas as well as continuous operational improvements via pricing and branding can also lift margins up.

By contrast, the other four top trends are likely to negatively impact the profitability of suppliers: OEM expansion increases competition, distributor consolidation adds price pressure, transparency will drive margins down, and the growing influence of intermediaries can lead to the bundling of demand and lower price levels.

Importantly, the net effect of those trends on the individual supplier depends on how well a player can react to the discussed changes in the market. Despite – and, in some cases, because of – the disruption there are opportunities for aftermarket players – suppliers, in particular – to successfully pursue profitability. As stated earlier, the aftermarket will remain an attractive industry as a whole with solid growth and healthy profitability. However, what is clear is that companies that do not adapt to changes in the market will lose ground soon.

To illustrate this, we have summarized the main effects that might negatively or positively influence margins, as shown in Exhibit 9. Obviously, trends such as further consolidation of distributors or the entrance of new players will likely push margins down. However, there are several opportunities that suppliers can benefit from and improve their profitability. Apart from new digital services, there is a lot of potential from operational improvements along the supply chain, including in pricing and operations streamlining. Also, partnerships with new entrants or players from other value chain activities might offer attractive opportunities for margin improvement.

Exhibit 9 A number of factors have positive or negative effects on suppliers' profitability – the net effect depends on how well players can react



SOURCE: Expert survey among CLEPA members (n = 27; February 2017); Capital IQ; Apple Annual Report 2016; McKinsey iConsumer survey 2015; Piper Jaffray; RIAA; McKinsey

Looking at industry structure, the digitization of channels will disrupt the supply chain with the potential to shorten it and cut out specific players that are now dealing with bringing (mainly) goods from manufacturers to customers. When thinking of a fully digital, interlinked supply chain, the role and value-add of certain wholesaling functions will need to be completely rethought.

As discussed earlier, the rise of and increased access to car-generated data will spur the emergence of completely new services and products, and digitization will enable newer entrants or players from adjacent sectors to develop and offer these products and services.

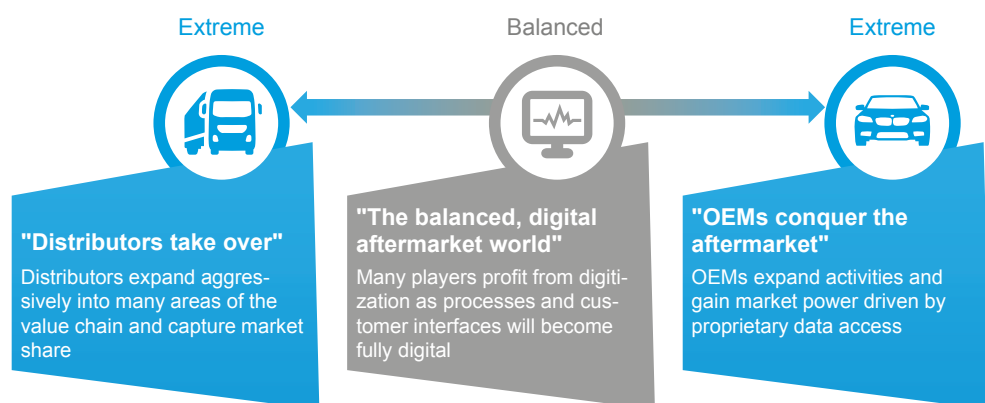
For instance, remote car diagnostics or routing services are not necessarily linked to companies that have actually produced a physical part of the car, such as OEMs or suppliers. New business models might emerge that completely change the traditional value chain logic of the aftermarket.

The remaining four trends are all linked to specific players in the value chain; therefore, each of these might change the industry as the role of each of those players changes.

Three aftermarket scenarios present highly divergent futures

During our extensive interviews with industry leaders and experts, we discussed the potential strategic moves for each of the five types of players along the value chain. Based on the resulting detailed, but non-exhaustive overview of potential strategy moves (see Appendix, Exhibit 14), we have developed three provocative future industry scenarios to present the broad spectrum of how the aftermarket game might change depending – not least – on the strategic moves taken by the players involved (Exhibit 10).

Exhibit 10 Of the 3 provocative future industry scenarios, 2 have an unfavorable outcome for automotive suppliers



SOURCE: McKinsey

What follows is a brief description of three scenarios: one "balanced" outlook and two more extreme scenarios with rather severe consequences for automotive suppliers.

"The balanced, digital aftermarket world"

In this rather optimistic outlook on 2030, players up and down the automotive aftermarket value chain profit from the digitization of processes and customer interfaces:

- **OEMs, suppliers, and distributors** reap the benefits of digitizing internal processes, adding value via car data, and focusing on e-commerce.
- **Intermediaries** gain visibility as they become "the face of the aftermarket" to the industry's customers.

In this scenario, market power remains relatively balanced, as most current player categories maintain their positions in the market. Even as new entrants establish themselves, incumbents in the industry hold on to the largest pieces of the aftermarket pie. Of course, even in relatively balanced situations, not every player wins. As intermediaries soar, workshops increasingly lose their direct customer connection.

“Distributors take over”

2030 could see aggressive distributor expansion, similar to what has happened in North America, into many areas of the value chain and capturing new market share via three main assets:

- **Direct customer access as well as data access** via workshops collaborations enhances distributors' analytics capabilities and customer relationship management skills.
- **Strong consolidation** in Europe results in the top 5 distributors controlling the majority of the market.
- **Control of the fleet business** becomes an asset due to distributors' superior logistics capabilities, and they benefit from a value chain that is connected end to end.

“OEMs conquer the aftermarket”

This outlook sees OEMs expand their activities and enjoy greater market power in 2030 – driven by proprietary data and customer access as well as analytics capabilities:

- **In-car customer interface.** OEMs control face-to-face customer interaction via their network of service workshops and are able to cut out other players from a large part of direct customer interaction.
- **Data analytics.** OEMs are able to develop excellent analytics capabilities, moving more and more into remote diagnostics and optimizing the value chain.

Many OEMs follow the examples of PSA and quickly enter into other steps of the value chain via partnerships and new ventures, while the activities of parts manufacturers and distributors are more or less reduced to supplying parts to OEMs.

Looking at these scenarios from a supplier's perspective, it becomes clear that there is a need to act. Not only in the two more extreme scenarios, but also in the example that depicts a more balanced world, the future position of parts suppliers is very different from today, including new business models, revenue streams, skill sets, and partnerships.

3

In order to capture the new opportunities, suppliers need to act now



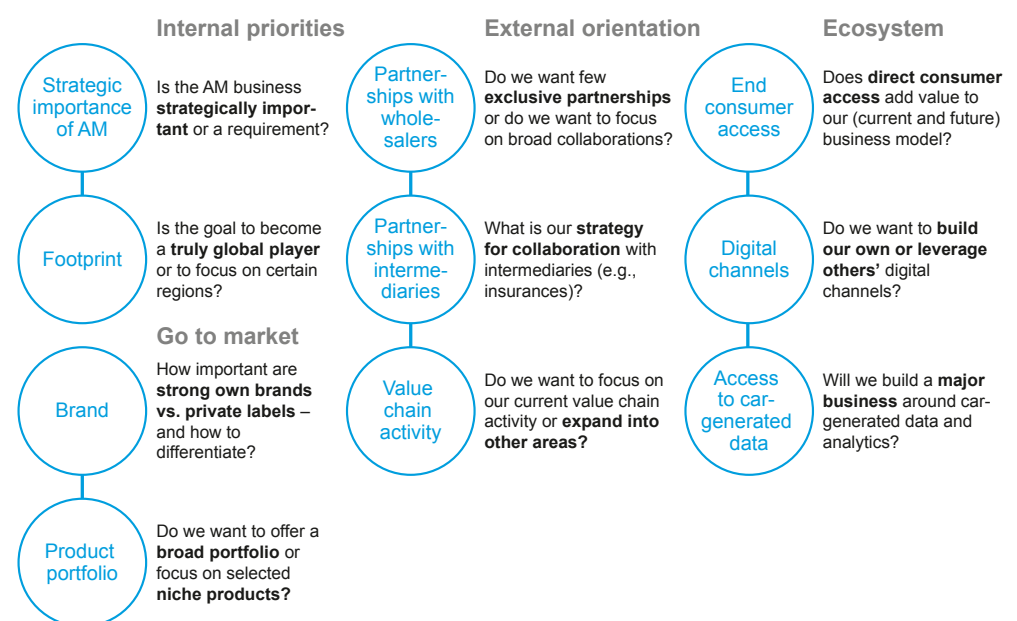
Our scenarios illustrate a broad range of potential market outcomes, but in each case, change is on the very near horizon. Automotive suppliers will need to start soon with their tailored strategic action planning to address the challenges and benefit from arising opportunities. This holds true especially for the 80% of automotive suppliers who say they are currently not yet prepared for the six trends and the disruption they are expected to trigger in the aftermarket. The disruption's net effect for each player is likely to depend largely on how well and how fast that organization can react.

10 dimensions to consider when developing an aftermarket strategy

Breaking down the rather abstract notion of “strategy” into the dimensions that players can influence offers them a way to think through their options for preparing successfully for the changes ahead. Therefore, McKinsey developed a framework to define a successful positioning for automotive suppliers in the aftermarket based on industry expertise and discussions with aftermarket executives. Specifically, we identified ten important strategic and operational dimensions that have to be mastered in four categories: internal priorities, go to market, external orientation, and ecosystem. For each dimension, there is a fundamental question defining the aftermarket business that every supplier that wants to play in the industry should answer for itself (Exhibit 11).

This framework should serve as a basic structure to support the strategic decision-making process for automotive suppliers. For instance, the question of whether a supplier wants to expand into other areas of the aftermarket value chain fundamentally determines its strategy. Apart from sticking to their current activities, suppliers might expand into adjacent steps of the value chain, in particular, distribution. Suppliers could also target steps of the chain farther from their core, including intermediary activities, such as fleet management. Similarly, the question of how to use digital channels can be approached differently. There are examples

Exhibit 11 We defined 10 strategic and operational dimensions along which automotive suppliers can position themselves for the aftermarket future



SOURCE: McKinsey

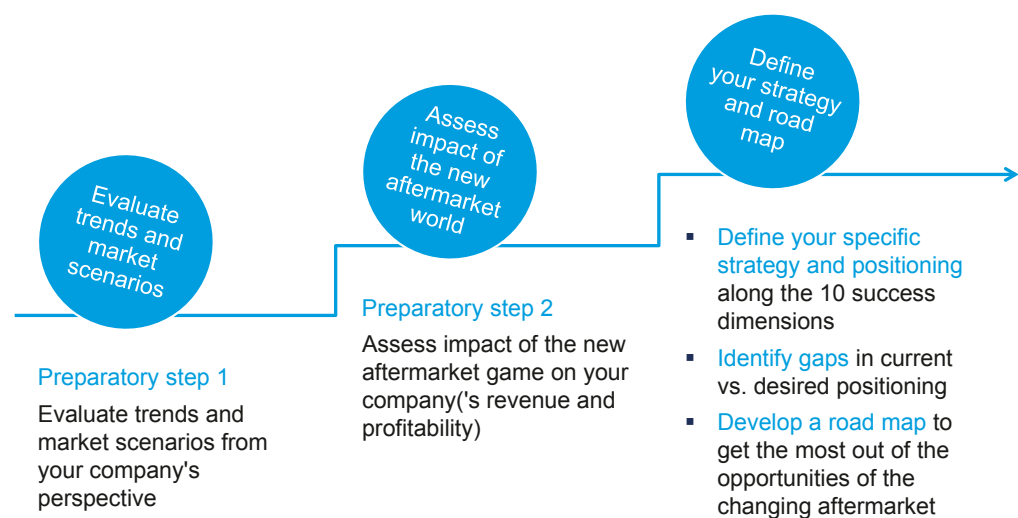
of suppliers that have started to promote their own, proprietary digital channels such as e-commerce. Others might choose to collaborate with partners (e.g., distributors, intermediaries) to build a strong new sales channel. For other suppliers, this might not be at the core of their aftermarket business and, hence, does not have strategic priority. Along these 10 dimensions, there is no clear road to success – every supplier has to find its own path.

It is important to note that the importance of each dimension might be structurally different across regions. The value of brands, as an example, is of higher importance in Western Continental Europe compared to the US or the UK, where private labels have a higher market share compared to countries like Germany or France.

A 3-step approach to developing a successful aftermarket strategy

As preparing for the future is managing under uncertainty, suppliers should follow a structured 3-step approach to tailoring their strategy planning (Exhibit 12). The two preparatory steps require suppliers to evaluate and assess our aftermarket-wide insights in the context of their individual organization and are thus rather self-explanatory. As such, we will limit the discussion of them to the following brief overview.

Exhibit 12 To think through their options and prepare successfully for the changes ahead, automotive suppliers can follow a 3-step approach to tailoring their strategy



SOURCE: McKinsey

I Evaluating new trends and potential market scenarios

First, it is important to identify the most relevant trends for your company and business model(s). Although the 12 trends we identified and, in particular, the top 6 trends we have prioritized will impact the aftermarket industry as a whole, some specific trends will have less or more impact on a particular company depending on its specific business.

Then, suppliers need to switch to an overall industry perspective and define the most likely market scenarios for each player in the value chain and combine them with one or more potential “future state(s) of the aftermarket”, similar to what we have done in the last chapter.

Finally, based on these first exercises, companies have to identify their individual strengths and weaknesses in light of the changing aftermarket. Two questions, in particular, may help them assess their starting points: Is customer access a competitive advantage to build on? Does the product and service portfolio have sufficient growth potential? It is important to evaluate these areas critically and answer the questions honestly with a look towards the future.

II Assessing the impact of the new aftermarket world/game

In the next step, it is crucial to make projections about the changes that the new developments bring to one’s business. We propose assessing the company-level impact along three dimensions: revenues, profitability, and business model, as we have shown on an industry level in Chapter 2. Importantly, the relevant scenarios should be quantified in order to have a good basis for decisions that have to be taken.

When these two preparatory steps have been completed, a company can start to define its new aftermarket strategy and develop a road map for implementation.

III Developing a tailored aftermarket strategy and implementation road map

The “defining moments” of planning for imminent aftermarket disruption occur in the third step. In the following, we offer detailed guidance on how industry players might develop, refine, and map their strategies.

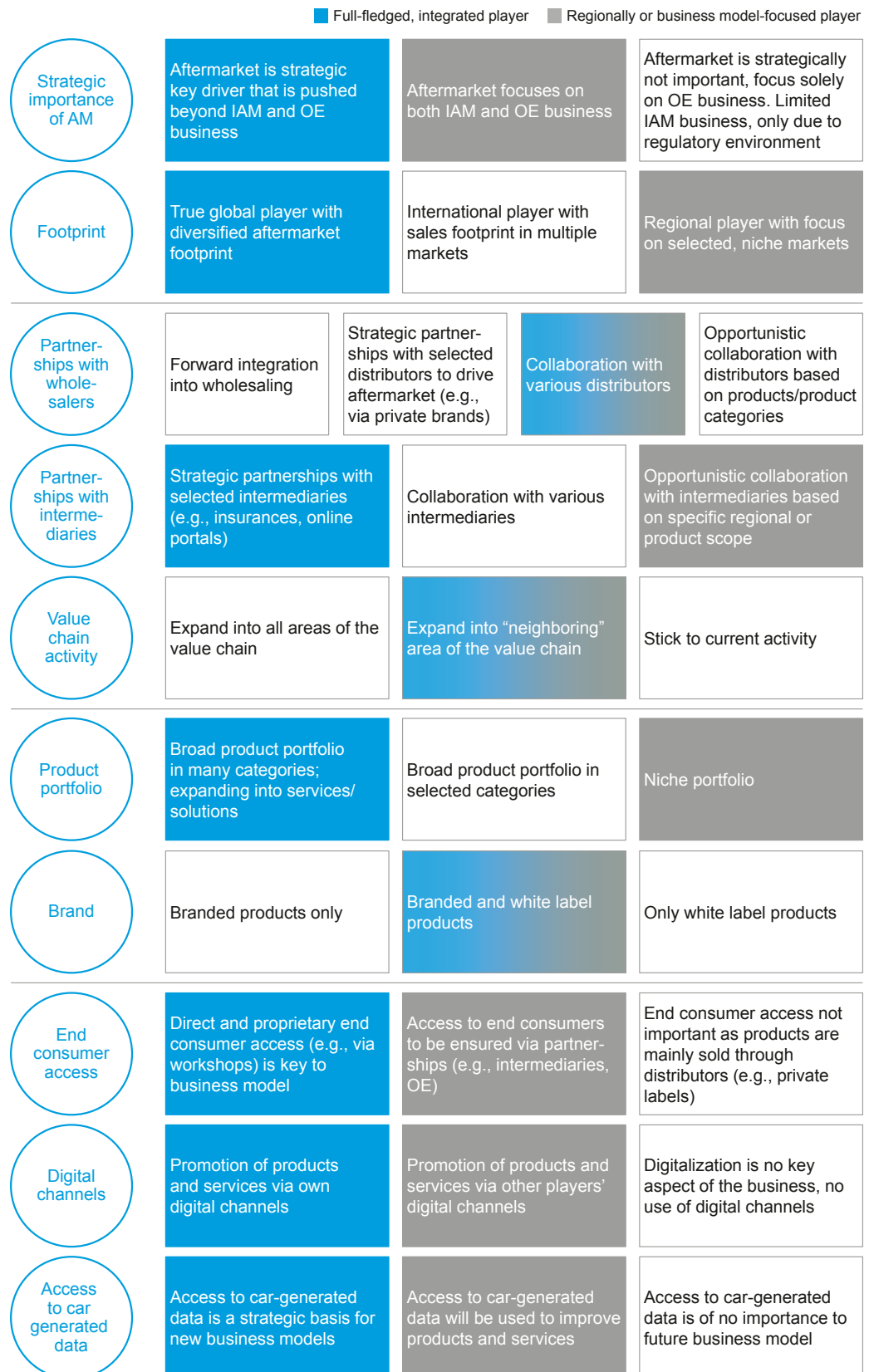
1. Define your specific strategy and positioning along the 10 success dimensions. Along the 10 dimensions, there is of course no “golden path” that every company has to take. However, through our research and analyses to probe the future of the aftermarket, we have identified several promising paths for several types of suppliers. In Exhibit 13 we illustrate – for guidance purposes – a promising path for two potential supplier business models: the full-fledged integrated player and the regionally or business model-focused player. Both paths are meant as useful simplifications, represent radical versions of supplier business models currently in the market, and illustrate sharply differing strategic priorities. It is important to note there are various types of suppliers between these two radical models.

Of course, the paths for the two player types differ on many dimensions, while they might make the same decisions on other dimensions.

2. Identify gaps in current vs. desired positioning. Once a desired path has been identified, companies need to compare this future positioning with the current one in order to identify gaps. These gaps then show where action is needed and what concretely has to be done in order to go from A to B.

For instance, if a company wants to expand into adjacent areas of the value chain but is currently a pure parts manufacturer, it has to decide which activities are most attractive, whether an expansion is feasible, and how it might be achieved.

Exhibit 13 There are several promising paths along the 10 success dimensions – each supplier has to decide on its positioning for the future



SOURCE: McKinsey, expert survey among CLEPA members (n = 27; February 2017)

3. Develop a road map to get the most out of the opportunities of the changing aftermarket.

Finally, every company needs to develop a detailed road map for how to put the new strategy into action. As with every strategy implementation plan, this has to include well-defined targets and end products, clear responsibilities, and strong leadership commitment.

It is important to mention that our projections focus on the next 5 to 10 years of the aftermarket. However, the decisions taken now should be made with the longer term in mind in order to stay ahead of the game and lead the industry into its next stage.

What are you waiting for?

“Getting your hands dirty” by getting the tailored strategy road mapping going and implementing the first strategy adaptations in your company does not require long preparation or a large up-front investment. Jumping in holds the benefit of producing early results and helping your company make quick progress on its journey toward becoming an organization that embraces the full potential of the changing aftermarket game – and is set to win it.

Without a doubt, these new challenges affect the industry as a whole, not only automotive suppliers. Topics such as access to car data require an industry-wide, fact-based, and non-emotional discussion. To take advantage of new opportunities, aftermarket players will need to explore new collaboration models that allow them to jointly develop value-creating, efficient solutions.

Appendix

Overview of potential strategic moves per player (not exhaustive):

Exhibit 14 Looking at market scenarios, there are several options for how each player in the value chain might act and develop in the future

Players	Selected potential scenarios per player			
OEMs	OEMs aggressively move into adjacent parts of their after-market chain (e.g., second service formats and parts)	OEMs increasingly try to own and leverage car and customer data via connectivity control	OEMs heavily invest into digital activities and e-commerce platforms	OEMs continue aftermarket operations largely as done today – no significant expansion
Parts manufacturers	Stronger collaboration with OEMs	Focus on strategic partnerships with distributors and investment in workshops (mainly IAM)	Strong investment into digital and e-commerce activities and/or partnerships, e.g., via direct distribution	Cooperation with strong intermediaries
Parts distributors	"Winner takes it all" dynamic – further consolidation and professionalization	Stronger vertical integration and closer link to workshops by technical assistance and full assortment	Stronger collaboration with OEMs to improve logistics and offer full program for fleets	Focus on leveraging car and customer data and offering new services via workshops and telematics solutions
Workshops	Consolidation and professionalization within network concepts – survival of the fittest	Workshops lose their position as primary customer contact as market goes digital	Development into large service factories , preparing for time of autonomous vehicles, etc.	
Intermediaries	Aggressive expansion into aftermarket (e.g., own workshop chains) to control repair and service volumes	Intermediaries concentrate on partnerships	Digital intermediaries becoming primary customer interfaces	

For each player, a combination of moves is expected

SOURCE: McKinsey

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