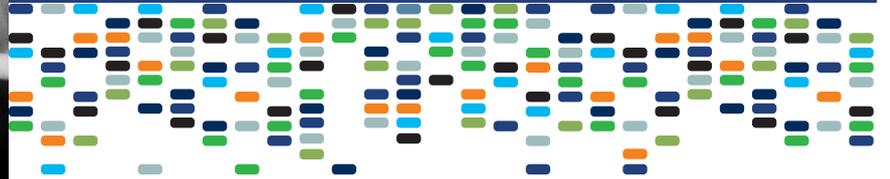


WHITE PAPER



Moving from Net Pricing to Retail Pricing

Risk or chance for automotive part
manufacturers in Europe?



The Aftersales market remains an interesting playing field for all part manufacturers

Influenced in part by the European economic crisis, the automotive aftersales market is predicted to remain flat in western Europe, with moderate growth opportunities in eastern Europe. Despite the market situation, there are good reasons for parts manufacturers to stay in the game.

First and foremost, the aftersales market is huge. According to Boston Consulting Group (BCG), in Germany alone, aftersales annually generate more than €30 billion. For some parts manufacturers, revenue generated from aftersales accounts for only 20% or less of total revenue, but represents 75%-80% of their profits.

The market remains very complex with many players. New players and new channels – including e-commerce players – appear on the market and Vehicle Manufacturers (VMs) or Original Equipment (OEs) are looking for market opportunities in the Independent Aftermarket (IAM) sector.

OEs are getting better at spare parts pricing at the retail level and making significant improvements in their service offerings. In disciplined markets like Germany, they can be considered the price setter and it is clear most have an eye for service parts pricing outside of their own vehicles. OE parts suppliers can have a significant influence on the market price. As studies show, European competition will become even more fierce in the coming years. IAMs, however, retain a certain advantage, with greater flexibility than OEs, a broader choice of parts, good availability and typically lower prices and better services. But, the OEs are catching up.



What's in it for the IAM channel?

The IAMs must differentiate themselves from the OEs not only by the breadth and quality of services, but also, most importantly, by price. "Parts availability" used to be the main driver for customer satisfaction, but price sensitivity is certainly one of the key drivers in customers moving from an authorized dealer to an independent repair shop.

It's well known by pricing experts that price is the main profit driver. In fact, in the automotive industry, a 1% price increase can translate into a 15-20% EBITDA increase. But, who sets the price and how?

In principle, in the IAM channel, the end customer price is set at the retail level. Retailers buy the parts from big purchasing networks and IAM wholesalers, while IAM wholesalers purchase parts from the parts manufacturers as shown as the Tier-1 suppliers in the picture below.

The value chain starts with the parts manufacturer, who has an important say when it comes to pricing. Typically, there are other big players that also have huge pricing power, like international purchase organizations, but also wholesalers and distributors. These companies leverage their size to get the best parts prices, and they have choices

because they are independent. For the same part with different quality levels -- like "Good, Better, Best" -- they can choose what to buy from a wide range of brands and suppliers.

The big wholesalers and automotive centers retain control over end-customer prices no matter if a retail price is defined by the manufacturer or not. The manufacturers have little insight into the prices charged to an independent repair shop or the end customer.

The IAM market opportunity for parts manufacturers is at risk because many markets -- especially in eastern Europe -- do not know a retail price. Spot prices are negotiated on a case-by-case basis. In principle, pricing is done on a net-price level, carried out in a reactive and random fashion. This also creates one of the biggest obstacles that hinder companies from effectively using the online channel. Their pricing is not consistent across different channels and for their customers in general. The inconsistent pricing across country borders and channels creates one of the biggest (if not the biggest) risk in today's spare parts markets -- the grey market threat.

Parts manufacturers face heavy headwinds

Increasing transparency into parts prices through e-commerce and intense competition will result

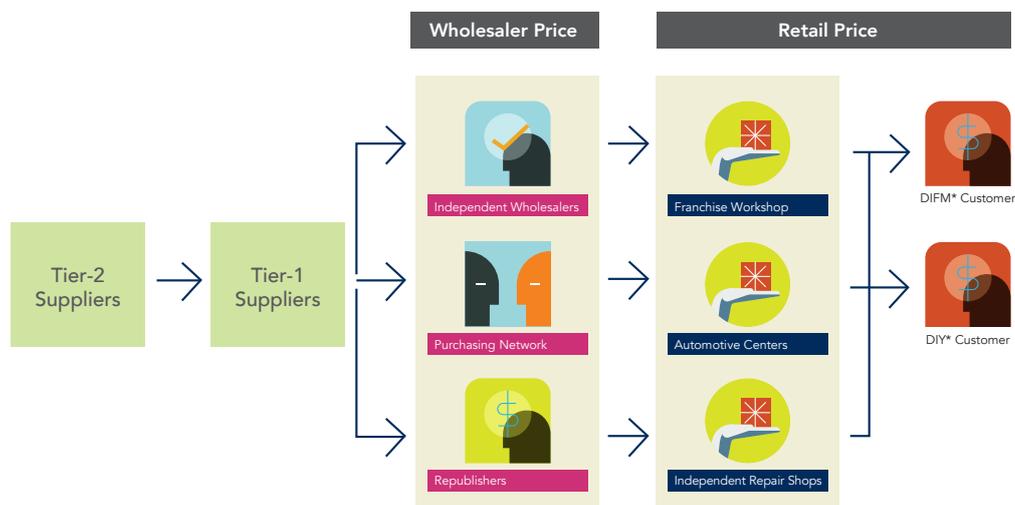
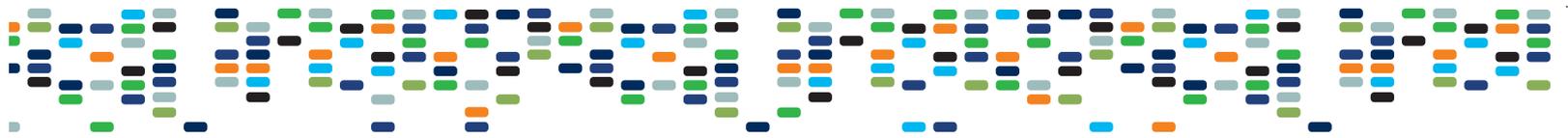


Figure 1: Automotive Independent Aftermarket Value Chain or Independent Channel



in prices decreasing even further. More intelligent pricing strategies and consolidated pricing across all channels and country borders are the solution for parts manufacturers. As a first step, setting country-wide retail price lists like those published as UVP in Germany goes a long way.

Many European markets such as those in France and Germany have established retail prices, but many countries in eastern Europe haven't. Overall, the automotive parts market is highly fragmented and very different in each country in Europe with manufacturers primarily looking at these markets on a country-by-country basis. As a result, price setting is often left to the sales organizations in each country. Most manufacturers don't have a European or global reference price list or defined pricing and discount corridors by region or country. For many countries, published retail prices are not available.



On the other side, international buying groups or international wholesalers are growing stronger and are present in many countries.

They are able to compare parts prices across country borders.

Also, some manufacturers don't have a clear brand strategy on how to position their different brands across countries in Europe. By and large, there's an absence of a pan-European pricing strategy with many manufacturers.

The good news is that IAM retail prices can only be set by the parts manufacturer. The bad news is that, in many countries, prices are set at the net-price level, which basically results in customer-specific prices. Typically, those net prices are defined based on the individual experience of the sales people. In most cases, net prices are set with a cost-plus approach using across-the-board target margins specific to product groups.

The situation today remains critical, especially for manufacturers because most elements in the price waterfall can hardly be influenced by the manufacturer (e.g. discounts/rebates to wholesalers are fixed). The retail price is the only variable. In the current situation, IAM retail prices are very much oriented toward the OE aftersales price. A common strategy is to use the OES price as a ceiling that assumes the OE will always be the price leader. Another common price strategy is



geared to determine the leading competitors in a product segment. This leading competitor will always be used as a proxy and price leader. Other manufacturers will then apply a follower price strategy. So, even if a retail price exists, pricing strategies are sub-optimal.

What are the consequences for manufacturers?

The definition of prices on net-price level independent from a "recommended" price always leads to a huge price variance for the same part. Pricing on a net-price level by decentralized country organizations makes it impossible to



pursue certain value-based pricing strategies. Suppliers also face the complication that they end up with a big number of customer-specific price lists that need to be maintained.

Typically, product owners define distinct pricing strategies, but it is often nearly impossible to translate those pricing strategies into net prices on the local level. Because of largely missing retail and global reference prices, it is very hard for manufacturers to ensure adoption of pricing strategies at the local level. It is also hard for them to enforce compliance and control in their local organizations.

Missing and inconsistent cross-border OEs & IAM retail price lists in many countries make it hard or even impossible to compare pricing across borders. Today, International buyers are better informed than the parts manufacturers. Also, the manufacturers' negotiation position against international buying groups is at risk because of random pricing on the local level.

The absence of a pan-European pricing strategy leads to inconsistent pricing in neighboring countries, which undermines business goals and creates additional risks. Manufacturers expose themselves to greater grey market risks with parts that are re-imported to higher price countries or sold cheaper over online channels.



As discussed, retail price setting is not optimal. Many manufacturers are blindly accelerating the trend by following competitor price decreases. Retail prices are typically set in a reactive fashion. Whenever a leading competitor moves a price, others are following. As a result, manufacturers are missing out on margin opportunities especially for captive parts.

The definition of prices on net-price level independent from a "recommended" price always leads to a huge price variance for the same part.

Recommended retail prices: a first step to recovery

We recommend that manufacturers always relate their local net prices to recommended regional or recommended global list or reference prices. A country-specific retail price that again relates to a global reference price would be a specific flavor of this. And, it does not really matter if that retail price is published or not.

The first step for suppliers should be to move the net-price countries to some sort of price list, ideally a published retail price list. As an intermediate step, an internal reference price could be used.

However, these price lists should ideally be related to a kind of "master" reference price list in one of the retail price countries. There needs to be a connection between retail prices in different countries, which will enable suppliers to compare price levels and to carry out benchmarking.

Starting from that "master" reference price list, manufacturers could then define local target prices or recommended price corridors. Those local target prices should be set again on the retail level, which influences the entire value chain.

Our ultimate proposal is that manufacturers develop a pan-European or global reference price list with the definition of regional or country corridors that facilitate local market specifics. This approach will enable compliance around global pricing strategies.

Establishing consistent or defensible retail prices throughout Europe will not solve all problems of the parts suppliers, but it is a first step to gain control of pricing and actively influence the prices for the end customers. Companies will realize multiple benefits:

- Value-added pricing strategies can be pursued and pushed out to the local organization, such as the positioning of parts by quality, “Good, Better or Best” brand positioning.
- Better pricing strategies considering the spare parts lifecycle can be executed, and distinct pricing strategies for captive parts and parts with “loose” competition can be put in place.
- Retail prices and discount levels from retail prices within in a country and also across borders can be compared and benchmarked.
- Consistent pricing against the OEM channel can be executed, which will help to strengthen the position of the IAM channel vs. OEM channel.
- The negotiation position of suppliers vs. the big buying groups will be strengthened. They will not suffer from inconsistent pricing on the local level and it will enable suppliers to compare prices across borders.
- Retail prices will help them enforce certain pricing strategies during the New Product Introduction (NPI) process.

- Grey-market risks will be better understood and concrete measures can be defined to mitigate the risks of retail and rebate/ bonus price setting, dependent on the same conditions in neighboring countries. Thresholds for price differences that should alert the pricing manager can also be defined.

Finally, additional steps should be taken on the pricing agendas of parts suppliers. Once retail prices are in place everywhere, fine tuning value-based pricing strategies and the optimization of retail prices should follow. This task can be supported by introducing professional pricing tools into the pricing processes and the application of list price optimization methods.



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About the Author



Reno Koepp serves as strategic consultant concentrating on pre-sales at PROS Germany GmbH. Reno has been with the company since May 2012. During the past 5 years Reno specialized in Aftermarket and Industrial Manufacturing.

Prior to joining PROS, he held various roles at Nokia Siemens Networks.

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