

How to unlock the hidden value of the customer?

Capturing maximum customer spending through dynamic pricing and bundling



In the last two decades all OEMs have found new space for growth by leveraging additional revenue streams that addressed downstream business and ancillary products and services. They realized that even though they were massively investing in marketing and sales activities that attempted to influence consumer perceptions in order to generate sales opportunities, they were achieving only 40% of customer spending.

At this time the situation has improved, but not changed significantly. The average customer share of wallet for many players in the industry reached a ceiling of around 55–60%. Nevertheless, further growth space can be found by hitting a higher share of overall customer spending and finding a better trade-off between volume and profit in mature markets. Arthur D. Little has identified and tested four pillars to unleash the full potential of the market, generating 5–6% of total revenue growth and from 4–5% profit increase. Transaction price optimization and value-based bundling are, among others, the most influential levers.

However, OEMs must be ready to transform their marketing and sales functions in HQs and national sales companies to benefit the most from our approach and make results sustainable in the long term.

Four forces are threatening OEMs’ growth

Sales decline led automotive players to overreact in order to maintain volumes and market share, the sector’s historical

metrics of success, which intensified the price war. OEMs tend also to imitate each other on short-term tactical promotions, increasing variable monetary expenditure to support dealers in achieving sales targets. Their focus remains on volumes instead

Four forces are threatening OEMs’ revenues and profit growth in mature markets



of trying to capture more revenues. These practices are eroding companies' operating margins, limiting the benefits from the recent market recovery.

OEMs are losing control of sales channels too. The rise of digitalization, smartphones and social media has narrowed most information asymmetries, increasing customers' bargaining power, since they can easily collect product and service information and compare competitors' offerings and pricing in advance before visiting dealers for quotations.

Despite the more open and collaborative customer behavior, dealer salespeople still employ a traditional engagement approach, remaining hostage to customers and focusing attention on discounts to survive. With this approach they lose the opportunity to leverage customer proximity to sell more products and services. Furthermore, all ancillary products and services, sold together with the car, such as financing, insurance and extended warranties, are up against indirect competitors. Commercial banks and insurance companies are persuading salespeople with generous rewards to propose "non-captive" products and services.

Shared platforms, power train and components are commoditizing the core product: the "car". The traditional product differentiation strategy, based on car features and performance, is becoming ineffective, which is exposing market leaders, especially for volume brands, to aggressive new entrants.

An impressive value is still ready to be unleashed

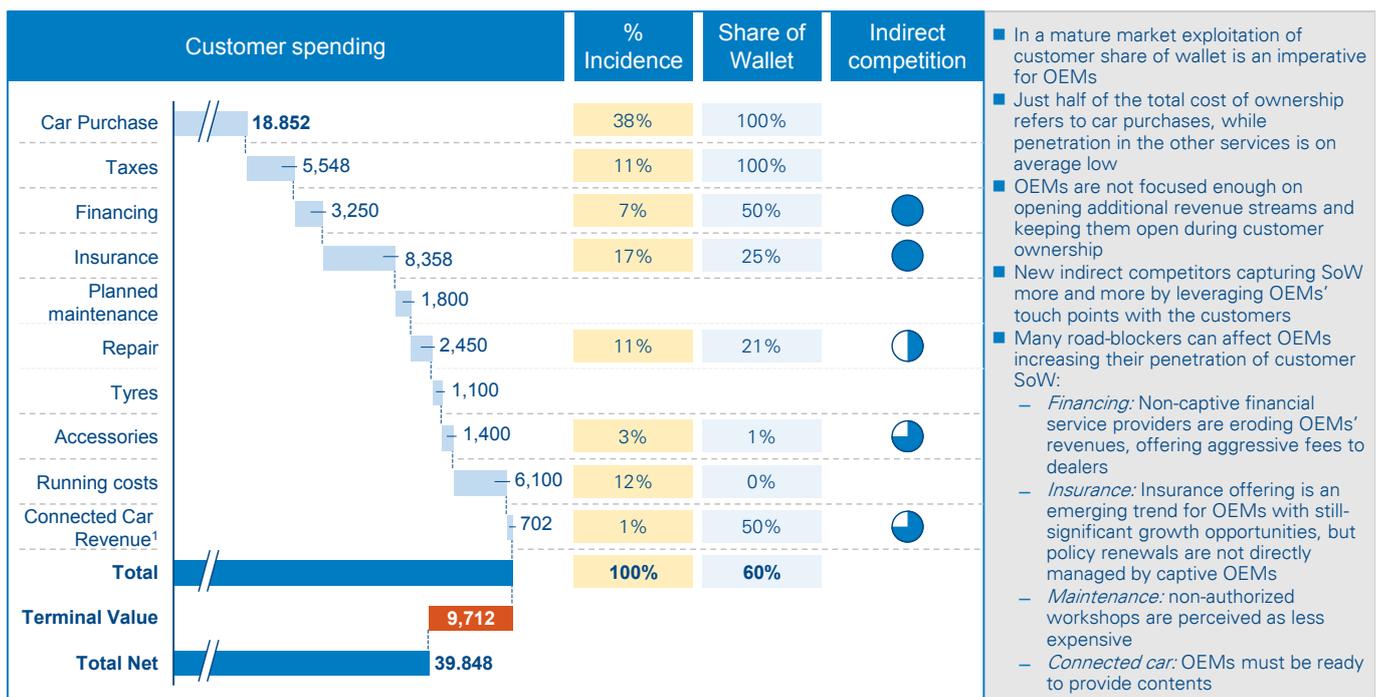
Considering the total cost of ownership of a C-segment car, a five-year holding period is around €40.000. Purchase price represents only 49% (including taxes) of total customer spending, while the remaining 51% is split over financing, insurance, running and maintenance costs, and purely ancillary products and services such as accessories and the embryonic connected-car costs.

On average OEMs are able to capture only 11% of additional revenues per unit spent in downstream business, sharing the rest with indirect competitors. In the following Figure the total customer spending is illustrated, analyzing average OEMs share of wallet and actual level of indirect competition over each component.

Exploitation of Customer share of wallet is an imperative for OEMs, which have been trying for a long time to capture these opportunities by setting up captive financial companies and agreements with several providers to offer such a wide range of services. Unfortunately for each product or service there are some road blocker that prevent OEMs to fully catch the full benefit.

Consumer credit was one of the first services provided by Automotive OEMs. However, the competition is very high since non captive financial service providers employ aggressive commercial offers luring the dealer salesmen with high fees.

Total Customer spending & average OEM customer share of wallet



Source: Arthur D. Little, estimation based on the average Italian market performance over 5 years ownership 1) Based on 2016 estimation; expected at 6% by 2020

Insurances expenses represent 17% of the customer share of wallet. OEMs have high growth potential in the insurance business through increasing the penetration within the customer base, taking the lead and boosting policy renewals as priority 1.

Even if original accessories represent only a minor share of the customer spending they are not considered by OEMs as a serious potential source of revenues. The car accessories sold care of the dealer suffer of low traffic flow, alternative consumer channel (e.g., internet marketplaces) are not currently exploited.

As of today connected cars related revenues are based on hardware provided by OEMs. In the near future connected car market revenues are expected to shift from hardware to software with an increasing spend on media streaming and content related services.

It is time to succeed ...

OEMs should fight challenges back, employing strategic moves to boost operating profits and increase revenues per unit sold. Arthur D. Little suggests four pillars to build a new successful commercial strategy:

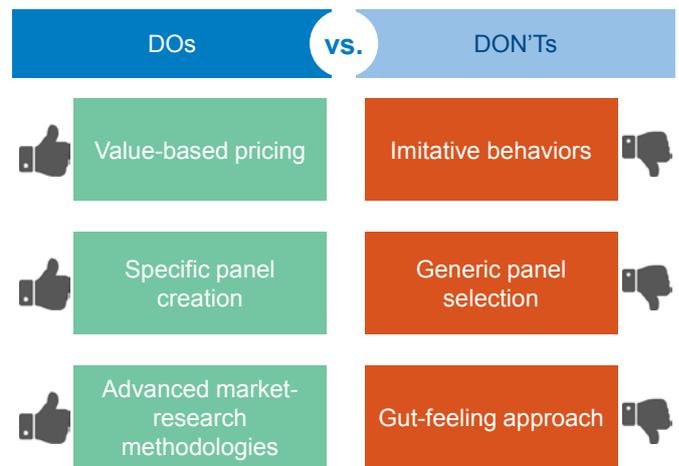
- **Sales support optimization:** pricing is a powerful tool to boost profit, but make it work is hard. Constant updates of price sensitivity curve would help OEMs to spot possible inelastic ranges to fine-tune the variable monetary expenditure (VME) provided to dealers to lower transaction price and achieve sales targets, eventually increasing the margin for each unit sold. Small adjustments of transaction price can lead to 4–5% profit increase;
- **Value-based bundling:** an outside-in approach based on customer perspective and needs can help reshape ancillary products and services bundles, making it simpler to sell and easier for the client to understand. The OEM can boost revenues per unit sold by 5–6%; reduce customer bargaining power, making the offer less comparable with the others; and better steer salespeople with simplified offering portfolios and clear incentive schemes;
- **From push to pull strategy:** leveraging digital channels consistently over all the touch points, OEMs can steer the entire organization by just maintaining a constant “dialogue” with customers along the entire purchasing experience and over;
- **Keeping the revenue streams open:** OEMs should start to exploit relevant revenue streams along the entire customer journey to increase revenues and maintain a “transaction-based relationship” with the customer base as the best proxy for future loyalty.

... but a proper deployment is crucial

A proper deployment is always a critical step to succeed in fine-tuning discount policy-recovering profits and creating a service bundle that can fully exploit revenue-up potential.

Based on Arthur D. Little project experience, we outline in the following selection of best practices and common mistakes deeply influencing the quality of marketing and sales project results.

DOs and DON'Ts



Accurate data collection is as important as its interpretation, since asking the right questions to the right people is the only way to have a statistically significant and reliable proxy of customer behavior. We identified three typical pitfalls, and include our “answers” to extract the maximum value from customer engagement:

- **Value-based pricing versus imitative behavior:** setting prices on the value perceived by the customer is the best way to reflect customer expectations and trade-offs. Products with higher perceived values can be leveraged in the bundle construction in order to deliver the highest value for the client, favor product penetration and help to sell less popular products and services.
- **Proper panel selection versus generic panels:** market research and surveys are often conducted on generic panels that may generate misleading results because they don't reflect the client customer base expectations or the product surveyed. Thanks to digital channels OEMs now have the opportunity to build their own panels specific to their customer bases or lost prospects, in order to identify the right commercial action for each customer cluster.
- **Advanced market research techniques versus gut feeling and business sense:** Customer behaviors have complex patterns, and the interpretation of the decision-making process requires advanced market-research methodologies,

such as choice-based conjoint analysis, which are able to cope with a significant amount of data. Bundle offers are impactful levers and should be based on solid and reliable quantitative data-driven processes.

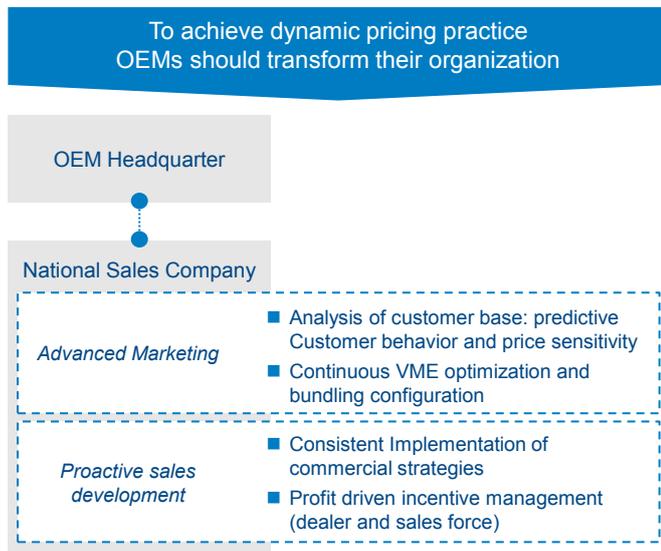
Conclusion

New-car sales in mature markets are expected to stay stagnant for the coming years. In this context, automotive brands chasing just volume growth will struggle to achieve both revenue increases and profitability at satisfactory levels.

Executives can find an immediate and impactful source of profit and additional revenues by exploiting market spaces that are still untapped, leveraging customer proximity without harming current sales volumes.

The central role of the customer demands that OEMs transform marketing and sales functions, in-sourcing key activities and acquiring new skills to deliver dynamic pricing and advanced bundling solutions continuously, as shown in the following and detailed as follows:

Company transformation for a new course



- **Customer proximity and proprietary panel selection:** new digital channels enable effective creation of in-house panels, specific to OEMs' own customer bases and lost prospects, to test pricing elasticity and customer preferences.
- **In-sourcing of core activities:** OEMs will have built in-house capabilities to perform critical activities such as market research and customer data management.
- **Acquisition of new skills:** transformation will cause a radical change in expertise required of personnel and the creation of new professional figures such as data-mining specialist, market-research specialist and customer-data manager.

Contacts

Kurt Baes

Belgium
baes.kurt@adlittle.com

Kevin Lee

Korea
lee.kevin@adlittle.com

Ralf Baron

Central Europe
baron.ralf@adlittle.com

Rodolfo Guzman

Latin America
guzman.rodolfo@adlittle.com

Russell Pell

China
pell.russell@adlittle.com

Thomas Kuruvilla

Middle-East
kuruvilla.thomas@adlittle.com

Aurelia Bettati

France
bettati.aurelia@adlittle.com

Niklas Brundin

Nordic
brundin.niklas@adlittle.com

Francesco Marsella

Italy
marsella.francesco@adlittle.com

Jesus Portal

Spain
portal.jesus@adlittle.com

Hiroto Suzuki

Japan
suzuki.hiroto@adlittle.com

Coskun Baban

Turkey
baban.coskun@adlittle.com

Authors

Francesco Marsella, Andrea Visentin, Riccardo Molinari

Arthur D. Little

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