Digging Beneath the Statistics

By Gary Smith

Recently, the following information was published in *The APRA e-Connection* e-mail newsletter, and reprinted in last month's issue of the *Electrical Rebuilder's Exchange*. This brief introductory essay raises some very interesting points, to which I am choosing to respond. I am inserting my remarks to facilitate easy reading within the context of the initial presentation.

"New Unit Programs Hold Revenue Generation Potential for Remanufacturers…Discount Rate Available for Automotive Parts Remanufacturers Association Members for Frost & Sullivan's North American Starters and Alternators Aftermarket Research.

"Frost & Sullivan, a global growth consulting company, along with the Automotive Parts Remanufacturers Association (APRA) is partnering to offer APRA a discounted rate on Frost & Sullivan's recently released research on the North American Starters and Alternators Aftermarket.

"Although remanufactured units accounted for approximately 92.3 percent of the revenues in the North American starters and alternators aftermarket in 2005, current trends indicate that this share will marginally decline throughout the forecast period as new units gradually gain a foothold in the market."

As any of you who read my article published in the October 2005 *Electrical Rebuilder's Exchange* will know, I see the automotive replacement market through the eyes of the replacement parts industry (the auto parts distributor) and believe that electrical rebuilders (and electrical rebuilder suppliers) are simply another form of an auto parts store.

I do not have, nor have I seen published, figures on market share penetration of new electrical units in comparison to rebuilt electrical units, nor do I know what group of sales activity Frost & Sullivan are accounting for in their determination of the North American Aftermarket.

I have no reason to doubt the figures quoted by Frost & Sullivan. I am sure they have carefully accounted for their figures based upon their chosen analytic metrics. One way or the other, a 7.7 percent market share is a very good foothold from which to more aggressively market any product.

"'New starters and alternators accounted for about 7.7 percent of the total aftermarket in 2005, which is likely to increase to 9.2 percent in 2012,' says Frost & Sullivan Industry Analyst Sanjay Vasudevan. 'The future growth rate of these units is likely to be relatively low, with revenues projected to increase from \$77.2 million in 2005 to \$82.9 million in 2012, and will take place at the expense of remanufactured units.'"

Now we are getting to some meaningful numbers and thoughts, which can be more carefully observed and responded to from the point of view of industry history. Remember, we (as the aftermarket industry) have been through this new replacing remanufactured cycle before. One specific product line (there have been several) that went through this same transition years ago was clutches, specifically rebuilt clutches.

If you momentarily look at the world of domestically manufactured cars with the eyes of around 1980, you will see that automatic transmissions had pretty well taken over the world; not completely but mostly. However, at the same time the import car invasion of the 1970's had moved well past the gaining traction phase and was proceeding to make inroads into the market share of the Detroit brands. Additionally, the import car was now old enough that demand was beginning to strongly appear in the replacement aftermarket, and (here is the important part) automatic transmissions in the early import car were almost non-existent.

At the parts distribution level, there was meaningfully renewed demand for clutches. On the West Coast, several remanufactured clutch lines had full import coverage and were seeing a very nice increase in business. In the 1980s, I was right in the middle of the import auto parts invasion, operating as managing partner in a small multi-line import only parts WD.

Here is a brief description of what I saw: In 1981 we stocked a full line of rebuilt clutches (remember, we were import only). In 1984 half of the rebuilt clutch line was gone and was replaced with new product. In 1987, three-fourths of the rebuilt line was gone, and by this point the only reason for stocking rebuilt clutches was price. If the remanufactured unit was not at least 30 percent less money, then it was a very hard sell.

What replaced the remanufactured product was new product. One Japanese manufacturer (Daiken), during this time, assembled a full line *program* of new import clutches (much of it of their manufacture, and the remainder from European OE sources) and in comparatively short order dominated the West Coast USA automotive import clutch market (whether in their brand or re-branded).

The product was exact OE, it exactly matched what the installer took off the car, and the customer resistance to the product was nil. Yes, it was more money than the rebuilt unit, but the price difference was normally 10 percent to 20 percent, and seldom over 30 percent, and often the same price. It was an easy sell, and a real no-brainer for the product purchaser.

Now, I admit that it could be argued that this was an unusual situation. Daiken was the primary OE supplier to most Japanese manufacturers for vehicles that had a clutch. This put them in a unique position to be able to assemble a full line program and still be able to depend primarily upon their own manufacturing capacity. Additionally, they were in a strong position to have exact product knowledge.

However, that does not diminish the main points of what made their program work: OE product knowledge and access to the manufacturing capacity, the will and insight to assemble a full line program, and the capital (some of it already in place) to do it.

With these tools in place, the marketing of the program was very easy. Yes, it was easier for an OE manufacturer to do it. But the point is, it can be done, and it can be very successful.

I tell you all of this because in the above quote, Frost and Sullivan is telling us that between 2005 and 2012, they estimate that the market penetration of new electrical product will increase from 7.7 percent to 9.2 percent. I would respond by saying that they may be correct; but based upon history they may also be very wrong.

If real full line coverage new unit programs appear in the aftermarket, their acceptance could be much greater than is being forecast. It has happened before.

"The projected growth of new units over remanufactured ones does not necessarily imply that total unit shipments will increase, but that new starters and alternators will eat into the share of remanufactured units."

This is a nice way of saying that we live in a mature marketplace. In all likelihood, our total market is as large as it is going to get, and in fact we may very well see it shrink, both due to a reduction in the number of "rolling units" and to increased longevity in the product appearing on the new automobile.

"In such a situation, many remanufacturers have started offering new units as part of their product portfolios to have more comprehensive product lines. New unit programs represent fresh revenue generation opportunities for remanufacturers that position these products as a premium offering."

Now isn't this interesting…"New unit programs represent fresh revenue generation opportunities for remanufacturers that position these products as a premium offering."

Wait a minute; just a moment ago Frost & Sullivan said that "…does not necessarily imply that total unit shipments will increase."

I think they are correct regarding the part about "not increasing unit shipments." I believe that this is a very mature market. But, what I find confusing is the part about "fresh revenue generation opportunities."

If the market is not going to be experiencing unit sales growth, then it is not very difficult to realize that for every new unit sold, there is one less rebuilt unit sold. For the rebuilder, this means that unless you are increasing your market share, by selling new units you are going to decrease your volume of rebuilt units sold.

The term I use to describe this is cannibalization. This is not inherently bad, if you manage your business accordingly. However, I believe that it is very mistaken to view this action as one of "revenue generation," when in fact it is one of "revenue preservation." The only way in which any of this can be viewed as revenue generation is if you are taking business away from someone else. Anything else is simply self-preservation.

"'While major remanufacturers are gearing up to be full-line suppliers with product diversity by offering new units alongside remanufactured ones, the high degree of price competition posed by large retailers and distributors creates a challenging situation for them,' says Vasudevan. 'This is likely to lead to widespread consolidation among remanufacturers.'"

Now we are getting to the meat and potatoes of the matter. Ah yes, the ever present whine, complain and desire of the parts distributor, and IMO, the nemesis of the rebuilder; consolidation.

The parts distributor (he thinks) would be most happy if he could buy just 100 (or whatever number you wish to substitute) units and cover the market (and trust me, next year the target will be 90 units). If you look around the rebuilding industry, you will see lots of rebuilders that in some way try to favorably respond to this desire. In my experience, it is at best a semi-futile effort that is heading for a lot of related problems.

If you remember my little story about Daiken, I made the comment that "it fit like OE and it looked like OE." Guess what…it was accepted just like OE. The burden of consolidation is that you have to *sell it* and fuss with it because it is not an exact fit…over and over again (in addition to hoping that it works as re-engineered).

For all of the reasons that I outlined in my article last year, part number proliferation is the friend of the rebuilder, and the (perceived) enemy of the parts distributor. The installer who is doing the work wants an OE fit. He will shop for price, but in the end he most often gets paid by the billable hours on the clock and problems (meaning installs that take longer than flat rate) come right out of his wallet.

The opportunity for the quality rebuilder is to maintain the OE quality fit and resist the temptation to consolidate for customer convenience. It is a very slippery slope.

Right now, the challenge for those selling new units is the OE fit and full application coverage. For those who are manufacturing new units, they have to fight parts proliferation in order to build economies of scale such that they can financially afford to play the game.

The opportunity for the prime new units supplier is a new units program that offers OE fit and adequate application coverage. I have over the last year reviewed most of the new unit "programs" that have been offered within the aftermarket. Up to this point, with one exception (and this is a player who is not in the rebuilder aftermarket), none of these "programs" were anything more than "Me Too" product assemblages that were made to look like a program, and had at best modest application coverage.

I now see this changing. Programs with meaningful coverage are beginning to appear. There is one new program on my desk today which is dramatically different from its prior incarnation, boasting large coverage with new unit numbers.

It is my opinion that as these real programs begin to appear they will (if priced correctly) begin to make noticeable penetration in the market on warehouse shelves.

The challenge for the independent rebuilder is to use new units for revenue preservation and to minimize his own sales erosion. I still believe that the rebuilder has the advantage, for all of the reasons that I previously outlined. But the days of being anything less than a professional business operator are long gone. To play in this game, you must be at the top of *your* game.

"New analysis from Frost & Sullivan (http://www.transportation.frost.com), North American Starters and Alternators Aftermarket, finds that this aftermarket earned revenues of $1.01 billion

in 2005 and is likely to reach $903.6 million in 2012."

These are interesting numbers, and certainly interesting language. Is it just me, or does this sentence come across sounding like, "Yes, we have no bananas." A quick read of this might lead one to overlook the significance of the numbers presented.

I would rephrase it to read as follows: "…, finds that this aftermarket earned revenues of $1.01 billion in 2005, and is likely to see net reductions in sales revenues by 2012, with projected revenues of $903.6 million, an overall revenue reduction of 10.5 percent. Additionally, if you factor in our estimates for growth in the sales of new units, this leads to an estimated reduction in revenue generation of rebuilt units of 12.0 percent."

I rest my case.

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