

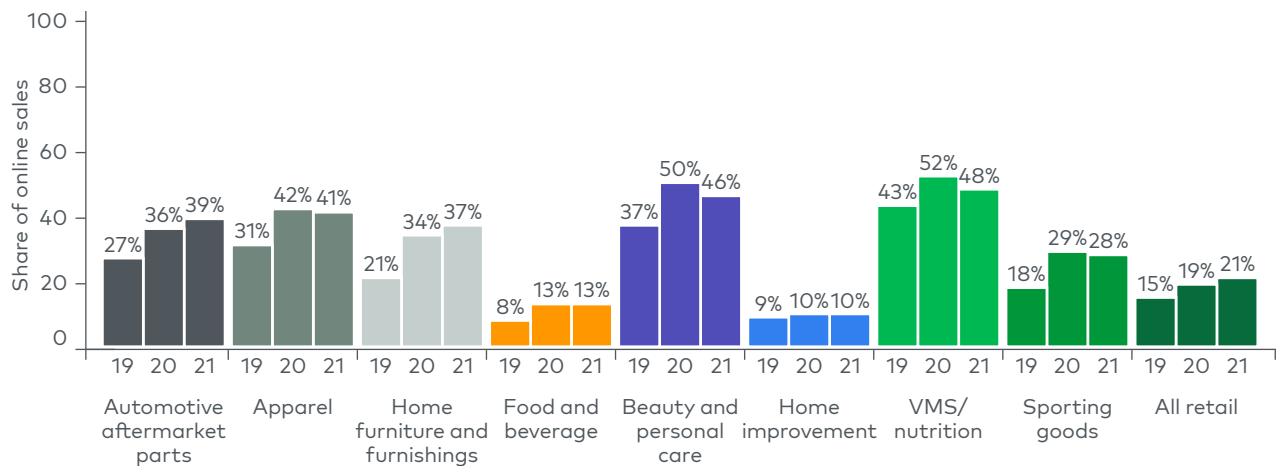


EXECUTIVE INSIGHTS

Direct-to-Consumer Sales: An Untapped Opportunity in the Automotive Aftermarket

To the astute market watcher, it should come as no surprise that consumer behavior across all industries is shifting online. This is especially true for the automotive aftermarket, where roughly 40% of sales are through ecommerce channels. This is about twice the ecommerce penetration of retail sales overall, and comparable to some of the most penetrated categories (see Figure 1).

Figure 1
US ecommerce penetration* by category, 2019-2021**



*M Science resource used for category ecommerce penetration is a collection of credit card sales data for a select number of representative brands for each market category

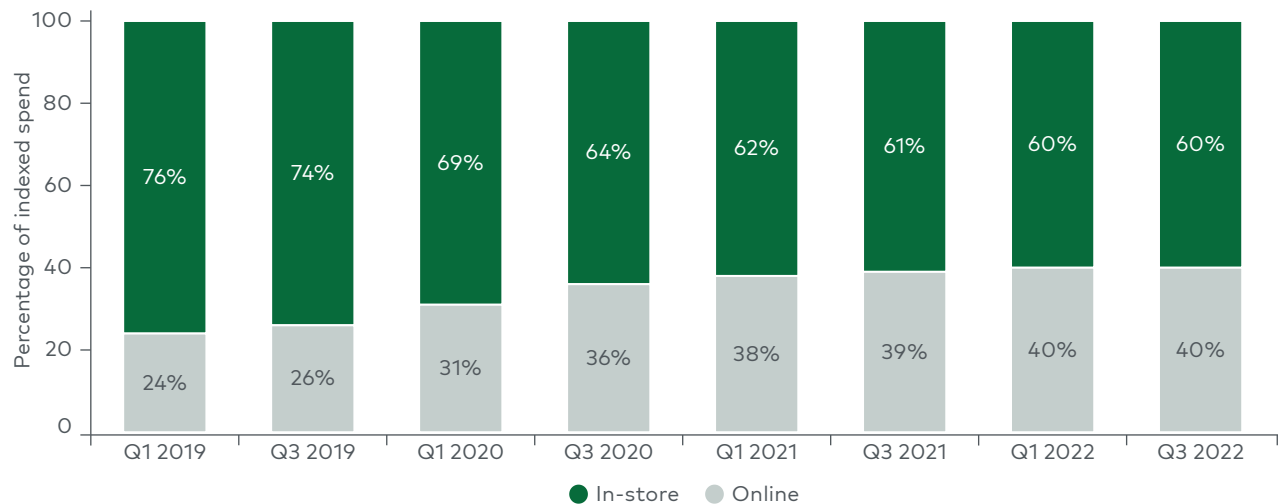
**Data last refreshed 11/12/22

Note: Brands included in the in-store channel were Advance Auto Parts, AutoZone, NAPA Auto Parts, Pep Boys and Walmart; brands included in the online channel were Advance Auto Parts, Amazon, AutoZone, NAPA Auto Parts, Pep Boys and Walmart; VMS=Vitamins, minerals and supplements

Source: M Science; L.E.K. Consumer Radar Tool, research and analysis

The automotive aftermarket is well suited to ecommerce given the category's complexity and extremely high volume of unique stock-keeping units as well as the need for purchasers (both do-it-for-me (DIFM) installers and DIY consumers) to access an extensive range of product and fitment information. Furthermore, online shopping also got an enduring boost from COVID-19, with significant growth in ecommerce penetration through 2021 and 2022 (see Figure 2).

Figure 2
US indexed spending, by automotive aftermarket parts,* Q1 2019-Q3 2022**



*M Science resource used for category ecommerce penetration is a collection of credit card sales data for a select number of representative brands in the automotive aftermarket parts category

**Data last refreshed 11/12/22

Note: Brands included in the in-store channel were Advance Auto Parts, AutoZone, NAPA Auto Parts, Pep Boys and Walmart; brands included in the online channel were Advance Auto Parts, Amazon, AutoZone, NAPA Auto Parts, Pep Boys and Walmart

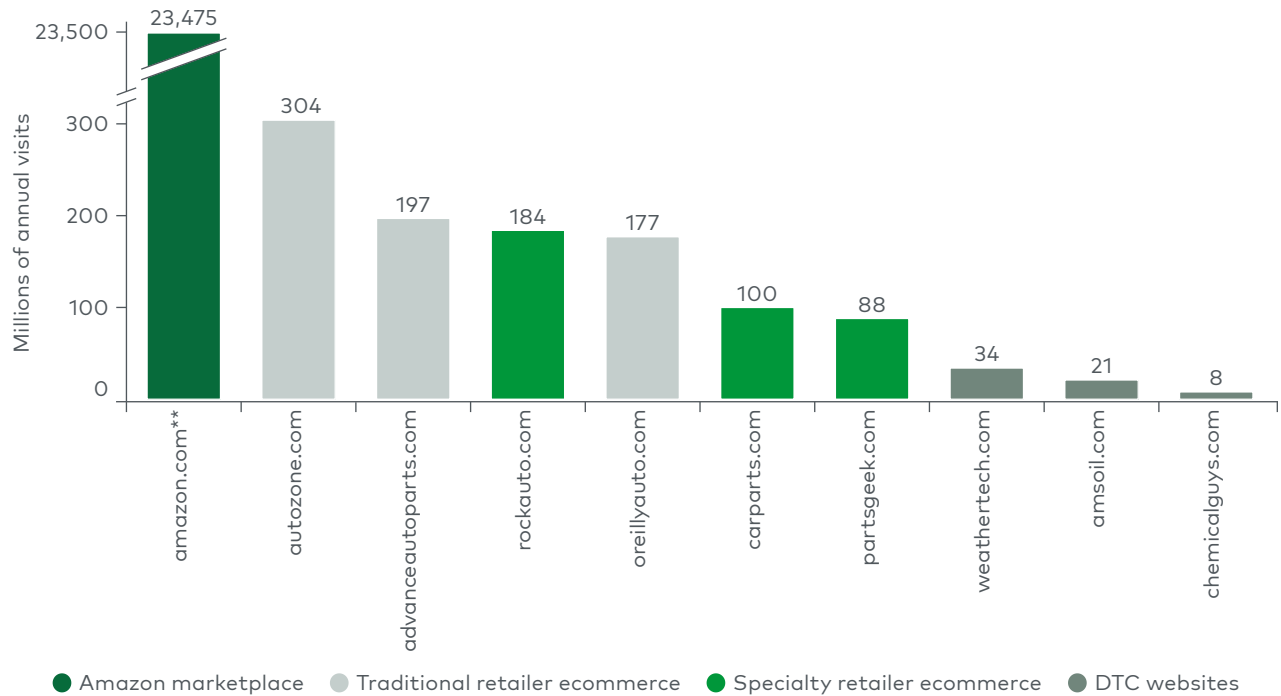
Source: M Science; L.E.K. Consumer Radar Tool, research and analysis

Today, brands are using three broad go-to-market approaches to cultivate an online experience for consumers:

- 1. Digital marketplaces** like Amazon or eBay Motors that offer a wide range of parts and accessories. The products are available directly from brands (i.e., on official storefronts) or through third-party resellers.
- 2. Retailer ecommerce sites** that offer a wide variety of products from multiple brands. These sites include ones from traditional retailers like AutoZone as well as from specialty retailers like RockAuto or RevZilla.
- 3. Direct-to-consumer (DTC) websites** that offer a company's products directly to customers. Examples include weathertech.com or chemicalguys.com.

So far, the traditional and specialty retailer ecommerce approaches have captured nearly all the ecommerce market growth. DTC efforts have remained on the starting line (see Figure 3).

Figure 3
Website visits by top brands across website types,* 2022

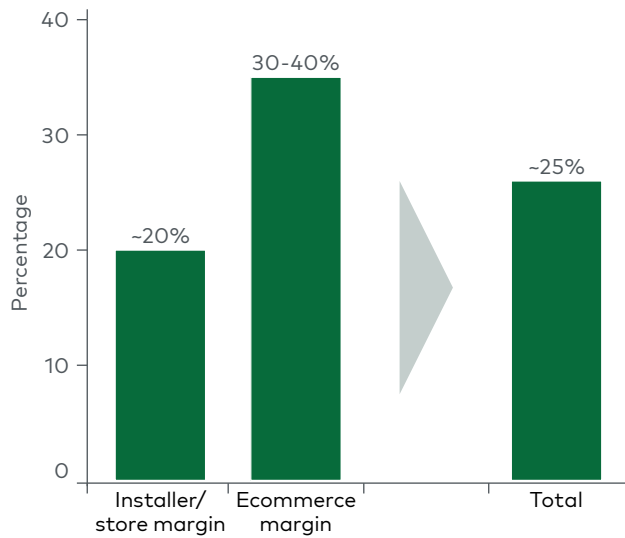


*M Science resource used is a collection of credit card sales data for a select number of representative brands in the automotive aftermarket parts category
 **Covers web traffic for Amazon broadly (i.e., web traffic does not focus only on automotive sales)
 Note: Time frame covered is November 2021-October 2022; brands included in the online channel were Advance Auto Parts, Amazon, AutoZone, NAPA Auto Parts, Pep Boys and Walmart; DTC=direct-to-consumer
 Source: SimilarWeb; M Science; L.E.K. research and analysis

The DTC channel is lagging as most automotive aftermarket brands lack a robust DTC strategy, making it a largely untapped growth vector that could yield a host of benefits to the brands that embrace a holistic DTC approach, not the least of which would be the higher margin potential from direct sales (see Figure 4).

Figure 4

Average retailer margin for vehicle performance parts, accessories and apparel distribution aftermarket, 2021



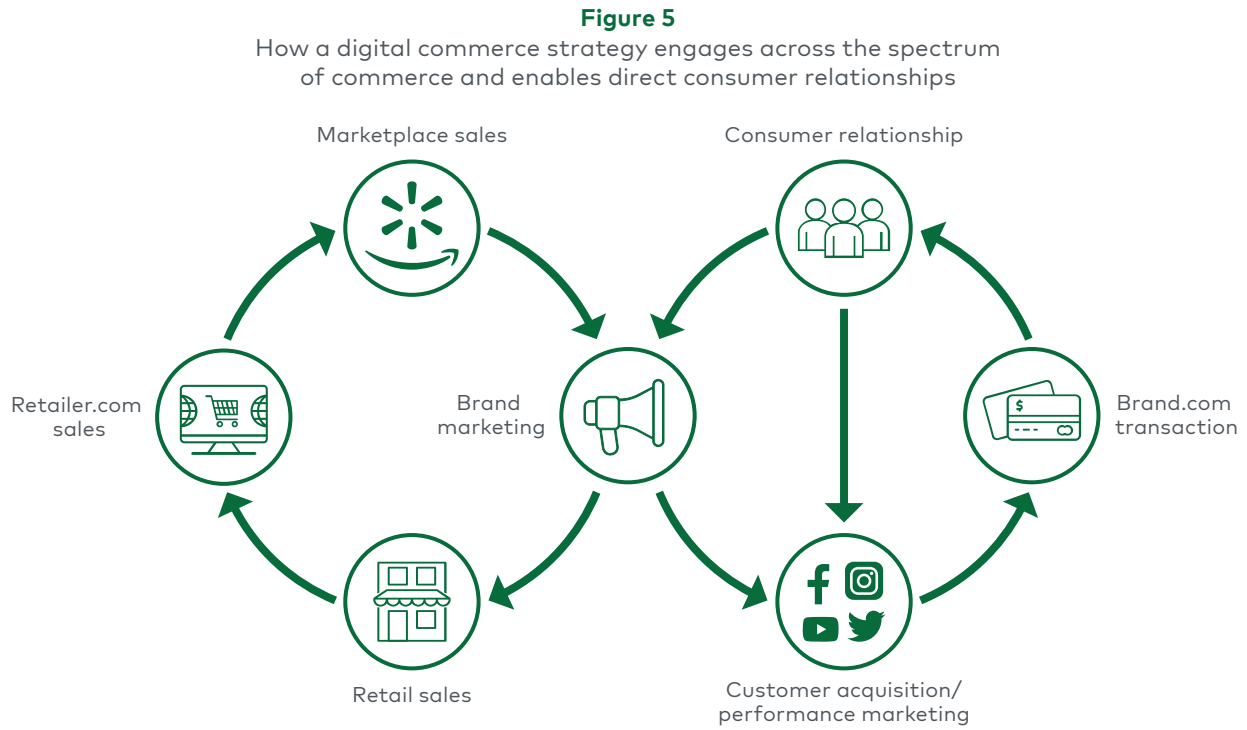
- Market feedback indicates a retailer margin range between 15% and 25%
- The overall retail selling price (RSP) to manufacturer selling price (MSP) margin is estimated to be between 40% and 45%, and is evenly distributed between the distributor and dealer
- Ecommerce retailers can achieve margins above 20%, estimated in the 30%-40% range, as they remove many costs associated with physical locations that cut into margins

Source: L.E.K. interviews, research and analysis

More horsepower for sellers

Higher margins aren't the only reason to develop a DTC strategy. Digital commerce plays a critical role in brand perception, loyalty and ultimate purchase intent. That's particularly so as end consumers increasingly begin their journey online. Already today, 37% of consumers say they prefer to research online, then buy in store, and by one estimate, 56% of in-store purchases are influenced by digital transactions.¹

And those are just the direct benefits. Indirectly, digital commerce allows companies to organically capture data related to their customer base. That in turn lets them target their marketing efforts better, such as by directing the right offers to the most valuable consumers. Digital commerce also limits brand exposure to shocks and disruptions within the traditional value chain. In this way, brands gain a hedge against larger macro trends and gain more robust distribution channels and greater ability to weather downstream changes. All told, these indirect benefits could prove even more advantageous over the long term (see Figure 5).



Source: L.E.K. research and analysis

A smoother ride for consumers

In addition to the benefits to brands, the automotive aftermarket also presents a number of stumbling blocks for customers that brands can help overcome with a strong DTC strategy.

Let's start, for example, with the do-it-yourself (DIY) segment. The proliferation of original equipment (OE) and OE-equivalent alternatives — all at varying levels of quality and price points, with varying levels of compatibility — drives customer confusion, complicates the automotive aftermarket and in many cases dissuades the potential DIYer from even embarking on a project. Brands can cut through that clutter and deliver a more educational sales interaction by providing a well-designed DTC experience that helps customers figure out what product to buy and how to install it.

Another simple yet practical way that a DTC strategy could assist both DIY consumers and DIFM installers is by helping them purchase the right parts the first time. The typical repair involves multiple parts, fasteners and accessories, many of which are not obvious when focusing on the part or the core issue to be addressed. Brands can and should make the job easier through creation of virtual "kits" to purchase at checkout that don't just simplify the customer experience but also position the brand to capture a higher sale for each ticket.

And what about the do-it-for-me (DIFM) segment? Many would-be end consumers at DIFM installers/repairers may begin their journey with online research; a comprehensive DTC presence can be an effective way to engage the ultimate consumer at repair shops in a way that brands have never been able to before.

Conditions for an effective DTC strategy

Even so, a DTC strategy isn't right for every automotive manufacturer. The brands that are best suited for one typically have at least one of the following:

- Products with a relatively high purchase frequency (e.g., at least one time per year)
- An expansive product catalog covering multiple categories and vehicle types
- An enthusiast brand with consumer pull
- A robust customer support infrastructure
- Products that especially serve either the DIY or DIFM consumer segments

Given the growing cost of online customer acquisition, brands need to consider the DTC channel as part of a broader omnichannel approach that encompasses multiple touchpoints, partnerships and cost-effective alternatives. Brands should view DTC as part of a larger investment in customer relationships rather than as an isolated expense. They need to make the most of their initial customer acquisition touchpoints and give customers a reason to return to the website, be it for digital content, unique products or other such features. Done right, brands can cultivate a strong first-party relationship that can lead to future interactions with customers, whether they return on their own or in response to prompts via email, a retailer app or other means.

Important as a DTC channel is, brands shouldn't focus on it to the detriment of other channels. They should also ensure that their products are being effectively represented on marketplaces. This is especially critical when it comes to Amazon, which brands should manage as a quasi-DTC channel because many search journeys start on Amazon and over 50% of American households are Prime members.²

Principles for successful execution

Suppose the conditions are right to develop a DTC strategy. Now what? Based on our work with various consumer brands, we've identified four foundational principles for successful implementation.

Know your customer. The data that online customers generate means that brands can get to know — and engage with — their customers in new ways (e.g., offering the right product at the

right price, at the right time and with the right message). But DTC alone won't produce enough customer data to effectively predict and speak to their needs. Brands need to think about the digital landscape in totality to fully take advantage of the current ecommerce environment.

Make use of third-party tools. Third-party tools can provide a stronger digital experience, including on marketplaces. Brands that don't have the staff to launch a digital commerce strategy can engage third parties to set up their entire digital commerce landscape.

Continually try to provide additional value to the customer. Brands should find creative ways to offer value to customers and then communicate these benefits and offers in order to build positive perceptions of the brand. Some companies, for instance, offer subscriptions for consumables. Others provide superior solutions (e.g., selling kits with installation instructions as opposed to the parts only).

Remember the professional/installer. By providing professionals a path to interact with the brand digitally in a way that meets their needs, brands can increase the odds of turning them into recurring customers. Once these recurring customers have been cultivated, brands should continue to make them feel valued and strengthen the relationship via trade or promotional pricing. Professional/installer customers are especially valuable because they not only steer customers, but they can also advocate for the brand to other professionals and end consumers.

Ultimately, aftermarket auto brands need to keep a few points in mind. First, just like other segments of consumer goods, auto part brands need to build stronger consumer connections. Second, a thoughtful DTC strategy can differentiate the winners from the losers by delivering a richer consumer experience. Finally, an effective DTC strategy can deliver significant value-added benefits to a brand's sales in other channels as well as aid product development and proximity to the end consumer. This can benefit the brand and the consumer, but also in many ways current distribution partners. All successful brands in the future will have to think like retailers, and today's aftermarket leaders need to spend time there to avoid being lapped.

Endnotes

¹Dot Digital Group, "Full year results presentation for the year ended 30 June 2020." www.dotdigitalgroup.com/wp-content/uploads/2020/11/FY1920-dotdigital-Results-Presentation-FINAL-161120.pdf

²Insider Intelligence, "Amazon's Move to One-Day Shipping Propels Sales." <https://www.insiderintelligence.com/content/amazon-s-move-to-one-day-shipping-propels-sales>

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