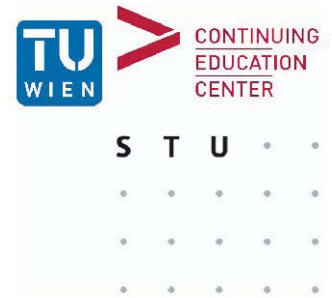


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Impact of Margins and Condition Systems in OEM - Dealer Relationship: Analysis of the Margin System to deduct Implications for a Bonus Model to steer Dealer Purchase Loyalty in the Automotive Spare Parts Business

A Master's Thesis submitted for the degree of
"Master of Business Administration"

supervised by

Univ.-Prof. Dr.-Ing. Dr. h.c. Dipl. Wirt.-Ing. Wilfried Sihn

Mag. Christina Stocker

9117930

Salzburg, February 2012



Affidavit

I, **MAG. CHRISTINA STOCKER**, hereby declare

1. that I am the sole author of the present Master's Thesis, "IMPACT OF MARGINS AND CONDITION SYSTEMS IN OEM - DEALER RELATIONSHIP: ANALYSIS OF THE MARGIN SYSTEM TO DEDUCT IMPLICATIONS FOR A BONUS MODEL TO STEER DEALER PURCHASE LOYALTY IN THE AUTOMOTIVE SPARE PARTS BUSINESS", 109 pages, bound, and that I have not used any source or tool other than those referenced or any other illicit aid or tool, and
2. that I have not prior to this date submitted this Master's Thesis as an examination paper in any form in Austria or abroad.

Vienna, 18.02.2012

Signature

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List of Abbreviations

AT	Austria
AAIA	Automotive Aftermarket Industry Association
ACEA	European Automobile Manufacturers' Association
BER	Block Exemption Regulation
CECRA	European Council for Motor Trades and Repairs
CI	Corporate identity
CRM	Customer relation management
DE	Germany
DIY	Do it yourself
EC	European Commission
EDI	Electronic data interchange
EOP	End of production
ES	Spain
EU	European Union
FR	France
FY	Financial year
IT	Italy
IAM	Independent aftermarket
IFA	Institut für Automobilwirtschaft
LU	Luxembourg
MVBER	Motor Vehicle Block Exemption Regulation
R&D	Research and development
OE	Original equipment
OEM	Original equipment manufacturer
OE	Original equipment
OES	Original equipment supplier
PC	Passenger cars
P&L	Profit and loss
SKU	Stock keeping unit
TFEU	Treaty on the functioning of the European Union
TQM	Total quality management
VW	Volkswagen

Abstract

Purpose of the master thesis is the description and analysis of the role of the dealer margin and bonus system as one of the central steering instruments of the manufacturer - dealer relationship, with reference to the actual legislative framework regarding automotive distribution and on the basis of a comprehensive study of the automotive aftermarket and description of automotive distribution channels. On the basis of the researched data and findings, conclusions are drawn how to design and improve a bonus and margin system regarding a more efficient and result-oriented and loyalty building bonus model in the automotive spare parts business. The practical implementation is shown on the basis of a management process.

The master thesis is based on a comprehensive literature study in combination with an analysis of practical approaches to gather valid and actual data. Internet sources and research studies were used as well.

1. Introduction

The aftermarket business is still one of the most profitable sources of revenue in the automotive industry. The parts business generates up to 40 percent of earnings for automakers and at least 30 percent for dealers. But this business is coming under intensified pressure, exerted by the increasing competition from independent parts dealers and suppliers as well as by the eroding purchasing loyalty of the automakers' own authorized dealerships (Oliver Wyman, 2010, p. 25 f). Independent workshops, fast fitters, independent wholesalers and intermediaries like insurance companies are pushing their way into the market, challenging the dominance of manufacturer-linked channels. While at the same time established aftersales markets in Europe are stagnating or even declining as a result of decreasing service needs per vehicle.

In practice, authorized repairers usually source spare parts from the vehicle manufacturers with whom they have an agreement. In order to stimulate competition also in the spare parts market, the European competition law framework for the automotive sector provides the possibility for authorized repairers to source parts directly from parts suppliers or independent parts wholesalers and to bypass the manufacturers' channels (Figiefa, 2010).

Due to this changing environment the system leadership of car manufacturers in vertical marketing channels has been decreasing in favour of their authorized dealer networks. Therefore the long-term maintenance of dealers' cooperation, which no longer can be taken for granted, is a key success factor for manufacturers. As a consequence they face the challenge to integrate, beside the end customer, also their affiliated dealer networks in their marketing activities. In this context relationship marketing with the use of the classical marketing instruments and the subject of customer satisfaction and loyalty is of high importance. With the use of appropriate measures not only customers but also dealers shall be bound to manufacturers in a long-term relationship.

Vehicle manufacturers are looking to maintain dealer loyalty by leveraging their logistics system for parts through the speed and frequency of delivery, technical support, parts quality and ultimately by their pricing policy. An effective margin and bonus system, as part of the pricing policy, is an important instrument for automotive manufacturers for the achievement of the sales targets and revenues on the one hand and for the stability of the distribution network, by supporting dealer satisfac-

tion, on the other hand. The bonus and margin system as the central monetary incentive instrument of the manufacturer has been developed continuously over the last years to emphasize the performance character of the remuneration.

1.1 Structure of the Work

This study starts with an introduction which includes the first two chapters. The intention is to give an overview of the organizational units of the automotive industry and to show the importance of the downstream business in the automotive market value chain.

The following chapter 3 will focus on design features and the organisation of distribution channels, where the business relation and cooperation between manufacturers and intermediaries takes place. It turns out, that in automotive distribution traditionally indirect channel formats in the form of legally independent contract dealers are prevailing.

The legal framework has considerable impact on the relationship between manufacturer and dealer in automotive distribution systems, therefore chapter 4 is intended to show the development and structure of the relevant competition law regulation as well as its impact on manufacturers' remuneration systems.

Chapter 5 provides a detailed description and analysis of the aftermarket structure. It shows developments and describes the competitive environment and other influencing factors with regard to the manufacturer-dealer business relationship.

Due to business possibilities for dealers provided by competition rules, changing environment, dealer cooperation is not guaranteed despite the existing contracts. Therefore in chapter 6 loyalty influencing factors and specific measures of relationship marketing are described which contribute to build customer/dealer loyalty.

Subsequently, chapter 7 looks into the price and conditions policy with the instruments of price differentiation. This is also the bridge to chapter 8 which gives a detailed analysis regarding content, requirements and conditions of automotive margin systems. The chapter concludes with the design of a management process concerning the implementation and development of a dealer remuneration system.

2 Structures in the Automotive Industry

2.1 The Organizational Units of the Automotive Industry

2.1.1 Automotive Industry and Automobile Manufacturers

For the term "automotive industry" different definitions are used in the literature. After looking through various definitions it can be summarized that with "automotive industry" all companies are comprised which are involved in the production, marketing, maintenance and also in the disposal of automobiles and automotive parts (Diez/Reindl/Brachat, 2005, p. 59).

The world's automotive industry represents one of the most important economic sectors. In many triad countries it has proven to be one of the strongest drivers of technology, growth and employment. The level of output is equivalent to a global turnover (gross revenue) of almost € 2 trillion. It is estimated that each direct auto job supports at least another five indirect jobs in the community, resulting in more than 50 million jobs owed to the auto industry. Many people are employed in related manufacturing and services. The automobile industry is also a major innovator, investing almost € 85 billion in research, development and production. This makes it a driver of technical progress and is the main factor behind the increasing technological connectivity between industry segments (OICA, 2011). The automotive industry is characterized by a strong international orientation and increasing globalization.

Automobile manufacturers (OEMs) are a subset of the automotive industry. An original equipment manufacturer is a manufacturer that incorporates components delivered by outside suppliers into its own product, then markets and sells the delivered component under its own company name (Gabler, 2009). According Meinig (1995) the term automotive manufacturer comprises in the broadest sense all enterprises which are involved in the final assembly of a vehicle. According Florenz (1992) the term automotive manufacturer covers all companies that are involved in the final production and in the distribution of automobiles (passenger cars and commercial vehicles).

In the last few decades growth and efficiency efforts have resulted in a decrease of the number of independent automobile manufacturers. Several mergers, takeovers and strategic alliances took place which resulted in a small number of large multi-

branded manufacturers (LE, 2006). The consolidation process and the trend to alliances in the automotive industry still continue. One of the most recent examples is the upcoming integration of Porsche by Volkswagen.

Group	Brand	Country of Origin
Volkswagen	Volkswagen Audi Seat Skoda Volkswagen Commercial Vehicles Bentley Lamborghini Bugatti Scania MAN (56% share)	Germany Germany Spain Czech Republic Germany Great Britain Italy France Sweden Germany
Fiat	Fiat Alfa-Romeo Lancia Maserati Ferrari Abarth Iveco Chrysler Dodge Jeep	Italy Italy Italy Italy Italy Italy Italy USA USA USA
G.M.	Opel Chevrolet Buick Cadillac GMC Vauxhall Holden	Germany USA USA USA USA Great Britain Australia
Daimler	Mercedes-Benz smart	Germany Germany
BMW	BMW Mini Rolls-Royce	Germany Great Britain Great Britain

Figure 1: Examples of Vehicle Manufacturing Groups and their Brand Portfolios (OICA, 2011; Spiegel online, 2011)

Importers represent a subgroup of automobile manufacturers. They distribute the products of the respective carmaker, but they don't have any production capacities in the respective country. Distribution and sales of the vehicles are organized through their affiliated retail organizations. In this work the term automobile manufacturer (OEM) applies to the producer as well as to the importer of a vehicle.

2.1.2 Original Equipment Suppliers

Original equipment suppliers (OESs) include all companies which participate within the automotive industry as manufacturers of parts, components, modules, subsystems and systems. The supplier industry is structured in several groups of original equipment suppliers i.e. each component affects different parts along the value chain. Therefore the following distinction is widely used: Tier 1 supplier is a component manufacturer delivering directly to final assemblers, responsible for the finished assembly, product development and continued technology innovation. Tier 1 suppliers work hand-in-hand with automobile manufacturers to design, manufacture and deliver complicated automobile systems and modules, such as significant interior, exterior and drive train units. Tier 1 suppliers in turn purchase from tier 2 and tier 3 suppliers, which rank below tier 1 (Heneric/Licht/Sofka, 2005, p. 19).

Today OEMs produce only about 20 to 30 per cent of the components used in vehicle production. The rest is sourced from original equipment suppliers. This growing reliance on parts from OESs leads increasingly to a situation where vehicle manufacturers just assemble a relatively limited number of highly complex ready-made modules that often represent large parts of the finished car. Original equipment suppliers are not only the most important source of automobile components, but they are, in addition, often thoroughly involved in the creation of new products and designs for the automotive industry. A number of important innovations in automotive technology have come from suppliers.

The use of outsourcing by OEMs led to a shift of responsibility, in terms of aspect of components, module, design and engineering, from assemblers to suppliers. This change contributed to increase the potential and the bargaining power of cost-effective and innovative supplier firms, as long as they developed technologies not possessed by others. In terms of size, global footprint, skills and innovative strengths, many of today's component suppliers certainly rank as equals with the car manufacturers they serve. In many cases, they dominate certain systems, functions and technologies to such an extent that OEMs have no choice but to live with the resultant dependencies. For example, Bosch, the world's second largest automotive components manufacturer, has an approach based on the building of a global network in which aftermarket sales are fundamental, which enabled the company to establish itself as the only alternative available to OEMs in some product areas, such as diesel fuel injection systems (LE, 2006, p. 194 f).

But on the other hand automotive suppliers have also to carry the largest share of cost pressure because of their large share of value creation. After all, the parts provided by suppliers are automakers' biggest cost item. As a result, suppliers are subject to unsparing and unrelenting cost pressure, which has been intensified even further by the latest crisis in the automotive industry (Oliver Wyman, 2010a, p. 1). The trend of alliances and consolidation observed across all subsectors of the automotive branch is extending to automotive parts and original equipment suppliers as well. For example, PwC reported that 189 component suppliers were acquired in 2009 and 278 in 2010 (PwC, 2011, p. 4).

Rank FY 2009/2010	Company	Country of Origin	Automotive Turnover FY 2009/2010 (in bn. US\$)	Turnover Previous Year (in bn. US\$)	Core business
1.	Denso	Japan	31,252	29,430	Thermal, powertrain control, electronic and electric systems; small motors, telecommunications, industrial and environmental systems
2.	Bosch	Germany	30,261	38,987	Fuel injection systems, chassis systems, energy and body systems, automotive multimedia and electronics
3.	Continental	Germany	26,483	34,852	Electronic brakes, stability management systems, tyres, foundation brakes, chassis systems, safety system electronics
4.	Bridgestone	Japan	22,981	25,429	Tires
5.	Aisin Seiki	Japan	21,028	20,562	Drivetrain, brake and chassis systems, body and engine related products
6.	Michelin	France	20,172	23,679	Tires
7.	Magna	Canada	17,367	23,704	Interiors, exteriors, body and chassis systems, seats, mirrors, closures, electronics, engines, transmissions, drivetrain
8.	Goodyear	USA	16,301	19,488	Tires
9.	Johnson Controls	USA	16,004	23,941	Seats, interior trim, batteries, electronics, cockpits and instrument panels
10.	Faurecia	France	12,948	17,687	Seats, cockpits, doors, acoustic packages, front ends, exhaust systems

Figure 2: Top 10 Automotive Suppliers and their Core Business, FY 2009/2010 (www.automobilproduktion.de, 2010; adapted from LE 2006, p. 197 f)

2.1.3 Automotive Retail

Retailing includes all the activities involved in selling goods or services directly to final consumers for personal, non-business use. A retailer or dealer is any business enterprise whose sales volume comes primarily from retailing (Kotler/Keller, 2006, p. 504). Retailers or dealers have a function as intermediate customers and intermediate suppliers.

Usually automotive manufacturers distribute their products through contracted or also called authorized dealers. From the manufacturers point of view the retailer is responsible for the distribution of new vehicles but also for providing aftersales products and services. Automotive dealers basically have to fulfil four main scopes of activities, which are: supporting the purchase decision, configuration of the buying process, delivery of the product and finally providing post-sale services. This task list

represents the performance of the dealer, for which in return he gets his remuneration in the form of the dealer margin (Diez, 2006, p. 307 f).

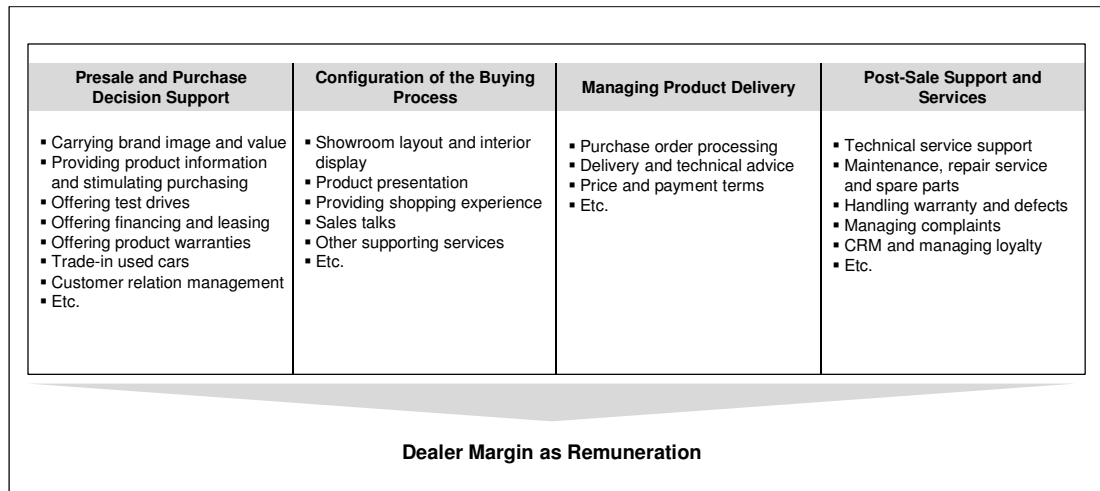


Figure 3: Car Retailer's Tasks and Scope of Action (according Diez, 2006, p. 307 f)

In the context of this work under the term car dealer all retailers are understood which are bound to one or more brands. These retailers are legally independent from the manufacturer and work on a contractual basis. Moreover also all standalone repairers are included. The total of all car dealers and service centers contracted to a vehicle manufacturer is summarized under the term dealer and service network. Details on distribution and distribution channel design in automotive industry will be further discussed in chapter 3.

2.1.4 The Automotive Market Value Chain

A value chain is a system of partnerships and alliances that a firm creates to source, augment and deliver its offerings. It includes a company's suppliers and its suppliers' suppliers and its immediate customers and their end customers (Kotler et al, 2009, p. 619). Michael Porter of Harvard has proposed the value chain as a tool for identifying ways to create more customer value (Porter, 1985, p. 36). According to this model, every firm is a synthesis of activities performed to design, produce, market, deliver and support its product (Kotler/Keller, 2006, p. 38). In the following Porter's value chain concept will be applied in a more extended cross company and cross market sense.

When talking about the automotive market in most cases the market for new vehicles is meant. This focus on new car business is legitimate as new car sales cause a variety of business activities which are linked upstream and downstream to the

new car sale. In the upstream business the market for product creation with design, engineering and assembly services and the supplier market for parts, components and modules can be distinguished. But there are also various activities related to the vehicle along its lifecycle. This so called automotive downstream business has a very broad scope and contains all activities and services related to maintaining a car after its initial sale until the end of its lifecycle. Therefore beside the new car market, downstream markets for automotive financial services (financing, leasing, insurance), car repair and maintenance, parts and accessories, used cars, and finally for disposal and recycling have developed. The recognition of the automotive market as a system of different markets is of high strategic importance. Finally the car manufacturers as system leaders in the automotive value chain have to decide which degree of vertical integration they are striving for (Diez, 2006, p. 17 f).

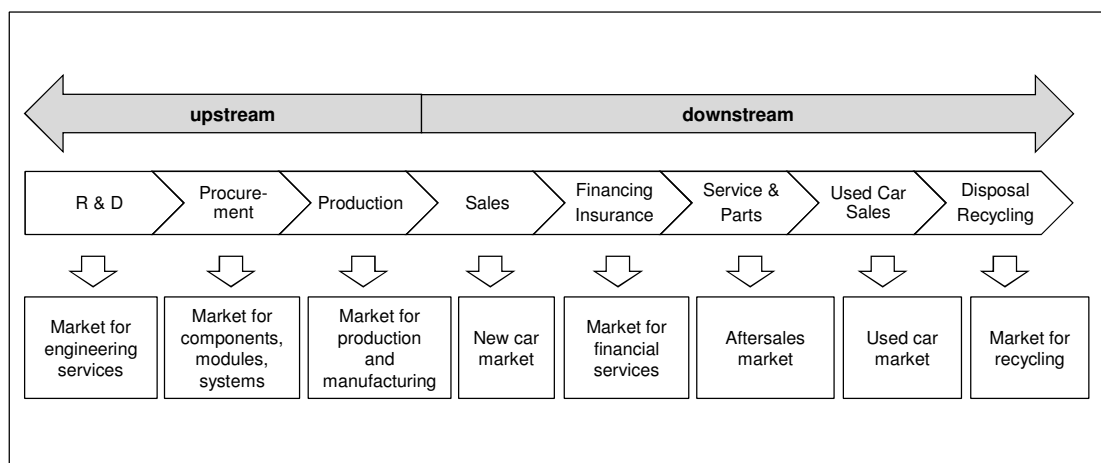


Figure 4: The Automotive Market Value Chain (Diez, 2006, p. 18)

As little cost savings potential remains in upstream product development and assembly operations, following the total quality management (TQM) and re-engineering wave of the last two decades, manufacturers are now increasingly focusing their attention on the downstream markets (Jullens/Smend, 2003, p. 97).

The downstream sector is the profit engine of the industry. Figure 5 shows its significance for the automotive industry. There is considerable profit potential in the downstream value chain, whereas new car sales make only a small contribution to profits. The new car business is under a great deal of pressure and is exposed to strong price-based competition. Globally, there is about 20 per cent excess capacity in the industry, leading to expensive rebate wars. The follow-up business with financial services, car maintenance, replacement part sales and used car sales account for less than 30 per cent of the industry's revenues, but they are responsible for 95

per cent of the profits. Today, the manufacturers' business model works almost similar like those for razors and inkjet printers. The product can no longer be sold at a profit, requiring all of the profits to be made in the aftersales service and support (Oliver Wyman, 2005; Arthur D. Little, 2010). The additional sources of profit in the downstream business are of utmost importance for OEMs because they are linked to the pool of cars in use and not to new car sales, which are always subject to cycles or dependent on the success of new models (Blanchet/Rade, 2007, p. 171). Therefore numerous manufacturers are seeking to gain increasing influence on these downstream markets in order to capture more value along the car lifecycle by a proactive downstream value chain management and increasing forward integration (Diez, 2006, p. 19).

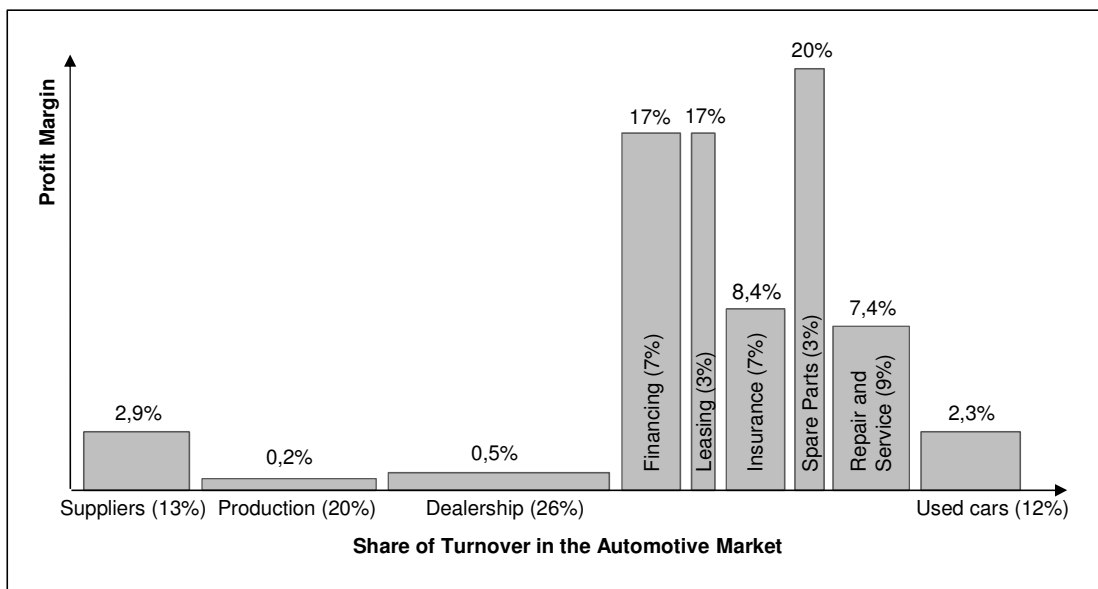


Figure 5: Profit Margins and Turnover Shares in the European Automotive Market (Palm, 2011, p. 66)

Safeguarding the high loyalty of contracted dealers and repair shops to OEM parts and distribution is one of the key challenges for automotive manufacturers to keep the high profits and to exploit the additional potential in the aftersales business. There is currently a wide loyalty spread among car manufacturers, ranging from 72 to 97 per cent (McKinsey, 2008, p. 73).

3 Distribution Channel Design

The special importance of distribution in automotive industry is due to the fact that the automobile is one of the most complex products sold in a mass production system, which also requires regular maintenance as well as unscheduled repair work. Therefore in automobile distribution the service aspect is of the same importance as the sales aspect when deciding about distribution channel. Moreover it has to be taken into account that distribution decisions involve long-term commitments to other firms. The development of the sales organisation is linked with high investment costs and is based on long-term contractual obligations (Diez, 2006, p. 266). When an automaker signs up independent dealers to sell its vehicles, the automaker cannot simply buy them out the next day and replace them for example with company-owned outlets (Kotler/Keller, 2006, p. 235).

In addition, the distribution system strongly influences all aspects of customer's sales and aftersales experience; network density directly increases market awareness and purchasing rates, while reputation, consideration and loyalty are heavily influenced by the appearance and quality of the customer interface (Jullens/Smend, 2003, p. 95). The distribution policy in automotive industry has become more important in recent years. A number of internal and external factors have contributed to this development: Beside the growing sales pressure as well as changes in customer behaviour also the changes of the regulatory framework play a major role (Diez, 2006, p. 266).

3.1 Basic Design Elements of Distribution Systems

Distribution channels are best described as vertical marketing systems, which transfer process responsibility from one layer to the next (Jullens/Smend, 2003, p. 95). They are sets of independent organizations involved in the process of marketing a product or service available for use or consumption. A distribution channel performs the work of moving goods from producers to consumers, overcoming the time, place, and possession gap that separate goods and services from those who need them or want them. This concept of marketing channels is not limited to the distribution of physical goods. Producers of services and ideas also face the problem of making their output available and accessible to target populations (Kotler/Keller, 2006, p. 236 f).

Basically the distribution channel system can consist of different types of intermediaries. It is task of the manufacturer to decide on the number and the kind of, potentially competing, distribution channels and to undertake a system-wide coordination between them. Basic design elements of distribution systems are shown in figure 6.

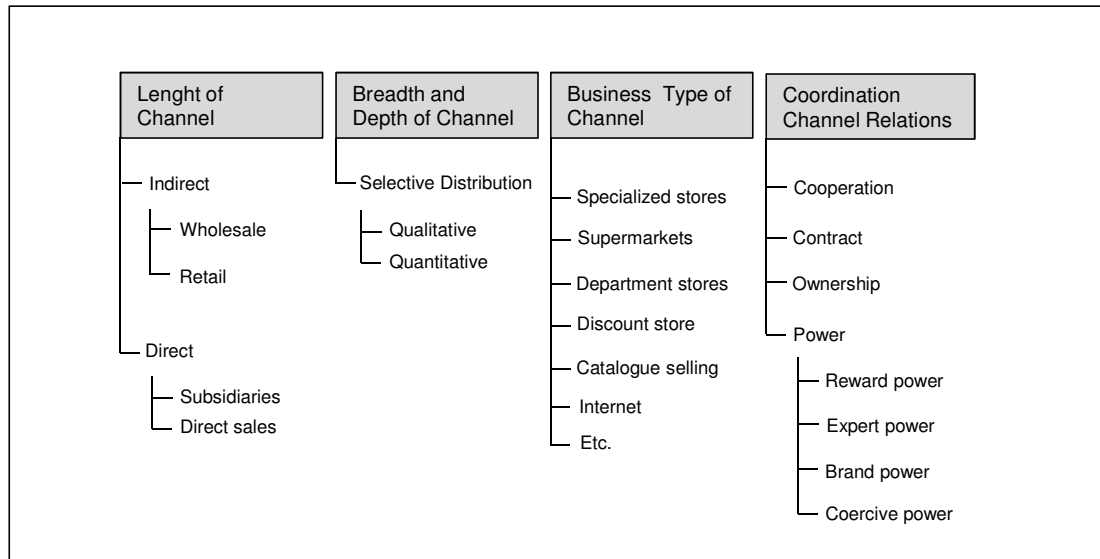


Figure 6: Design Elements of Distribution Channels (Diez, 2006, p. 267)

The producer and the final customer are part of every channel. The number of intermediary levels (vertical selection) is used to designate the length of a channel. Basically direct and indirect channels can be distinguished. Direct sale means distribution to final customers by the manufacturers themselves, whereas indirect sales channels contain one or more selling intermediaries. These intermediaries are legally and economically independent enterprises. From the producer's point of view, obtaining information about end users and exercising control becomes more difficult as the number of channel levels increases (Kotler/Keller, 2006, p. 238).

The depth of the vertical chain refers to the type of intermediary involved in the sales channel, the breadth of the vertical chain describes how many intermediaries of the same type are used. Regarding the design of the depth and breadth of the vertical chain, intensive distribution, exclusive distribution and selective distribution can be distinguished (Diez, 2006, p. 268). Intensive distribution consists of the manufacturer placing the goods or services in as many outlets as possible. Exclusive distribution means severely limiting the number of intermediaries. Firms use this approach when they want to maintain control over the service level and service outputs offered by the resellers. Selective distribution involves the use of more than a few but less than all of the intermediaries who are willing to carry a particular product

(Kotler/Keller, 2006, p. 241). Such selection can be carried out based on qualitative or quantitative criteria and is linked with certain restrictions and obligations, such as allocation of distributors to an exclusive sales territory or purchase or sales obligations. Regarding the design of intermediaries different business types can be distinguished, which can be characterized according the following criteria: type of location, size of sales area, size and range of assortment, number of sales outlets, type of customer contact and price policy. Typical business types are specialized stores, supermarkets, discounters, department stores as well as catalogue selling and web retailers. The fourth design element of distribution systems is referring to the coordination mechanisms of the relationships between manufacturers and sales intermediaries. Basically four coordination principles can be distinguished, which are coordination through power, coordination through contracts, coordination through cooperation as well as coordination through ownership. These coordination mechanisms specify on how cooperation between manufacturer and intermediary is regulated. It should be noted that they don't exclude each other (Diez, 2006, p. 268 f).

3.2 Structure of Automotive Distribution Channels

The automotive industry's distribution system is dominated by indirect channel-formats which are characterized by a multi-tiered sales structure that involves manufacturers, wholesalers, retailers and in some cases subsidiary dealers, or agents (Jullens/Smend, 2003, p. 95).

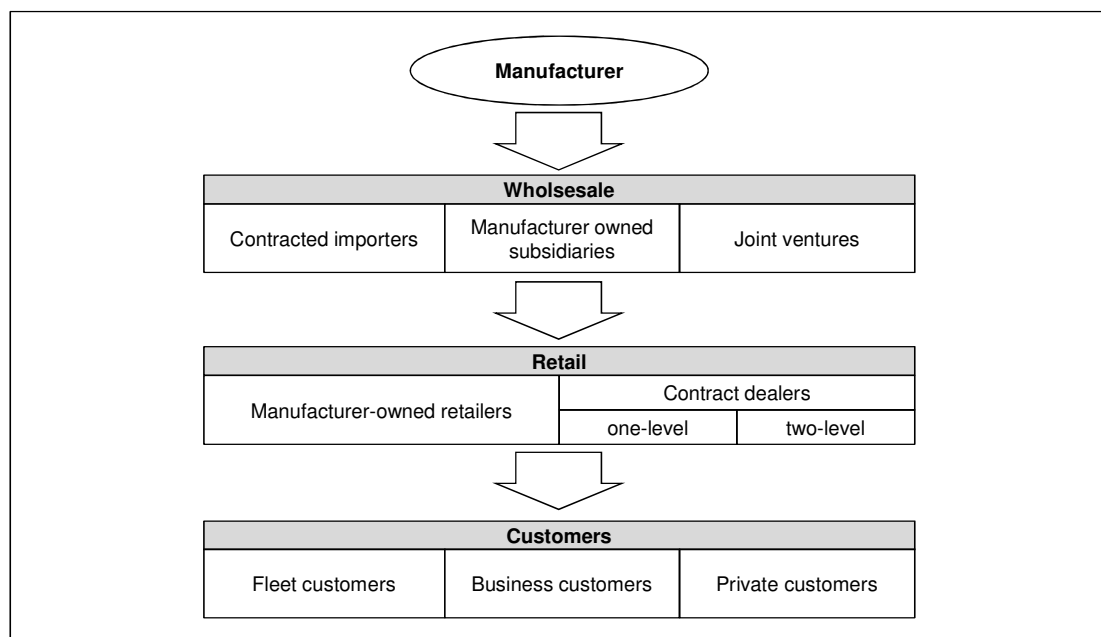


Figure 7: Basic Structure of Automotive Distribution Systems (Diez, 2006, p. 270)

In the design of the wholesale level there are three alternative systems used (Diez, 2006, p. 269, according Brockmeier 2000, p. 15 f).

Distribution via contracted importers (2 layer distribution): The manufacturer transfers the distribution rights for a specific country to a legally and economically independent importer, who takes the overall responsibility for the market development in the respective country, for which he gets in return an adequate margin (Diez, 2006, p. 270). Many smaller markets are often served by importers, where it would be too costly for the manufacturer to establish an own subsidiary or distribution network. When the purchasing potential in a country is growing and the company sees strong opportunities, the car manufacturer will change to an own subsidiary to get more influence on sales. Volkswagen for instance moved in 2008 in Hong Kong and Macao from an importer to its own subsidiary to penetrate the market (Kroll-Thaller, 2010, p. 94).

Distribution via manufacturer-owned subsidiaries: In this case the national sales company is a 100 per cent subsidiary of the manufacturer. In high-volume markets car manufacturers usually use this form of distribution by their own national sales companies. In particular premium manufacturers try to control distribution in a new market at an early stage (Diez, 2006, p. 271). In the wake of the Block Exemption Regulation, manufacturers have also invested in integrating independent importers to maximize their access to core European markets. These firms have spent considerable sums to buy outright or acquire a majority interest in previously independent importers. Although many auto makers have integrated the wholesale level in the larger markets, the traditional principle of 'one country, one company' remains generally valid (Reers, 2007, p. 158 f).

Distribution via joint-ventures: A middle way between the aforementioned alternatives is the formation of a joint-venture between the manufacturer and the national sales partner. Reasons for this approach are mostly legal restrictions regarding the foundation of an own subsidiary in a country or the attempt to use the market knowledge of the national importer while controlling the market development at the same time.

At the retail stage, traditionally two distribution channels are dominating in the automotive industry: Retail via manufacturer-owned company outlets, as well as via legally and economically independent contract dealers. Manufacturer own company outlets allow high standards with regard to showroom, salesman qualification and

service (Kroll-Thaller, 2010, p. 94). A contract dealer system can contain two or more levels. Moreover there exist hybrid forms between own-retail and contract dealer systems. For example the distribution via sales agents can be regarded as a hybrid form between direct and indirect distribution, since the agent concludes contracts in third-party name and on third-party account for which in return he receives a commission (Diez, 2006, p. 271).

Practically all car companies have been restructuring their sales networks for years and have invested huge sums into sales and dealerships. First and foremost, they have set up their own outlets to reinforce brand identity. They have restructured sales networks to improve dealer quality, and they have also integrated wholesale activities in order to improve market access. Auto makers invest hundreds of millions in their own outlets and brand experiences to give a lift to the presence of their brand in metropolitan areas. In 2000, 53,000 main dealers ran a total of 106,000 sales outlets in Western Europe. By 2004, the numbers had shrunk to 43,000 dealers (a decline of almost 20 per cent) and 74,000 outlets (a decline of 30 per cent). In addition, where network adjustment involves recruiting new, more professional dealers, the car makers also have to pay investment support and increase their marketing budgets to launch the new dealerships (Reers, 2007, p. 159 f).

3.2.1 Distribution via Contract Dealers

In general, a contract dealer can be described as a legally independent firm which sells goods on a contractual basis in its own name and on its own account, according to a manufacturer's concepts and programs (Ahlert, 1991, p. 215). The contract dealer expresses his affiliation to the manufacturer's distribution network by using the manufacturer's label in the course of business, but he doesn't abandon to use his own company name (Meffert et al, 2008, p. 587).

Regarding its business type, an automotive contract dealer is a specialized retailer which is characterized by a narrow automobile-specific product range, the offer of a high-quality advice and support as well as the providing brand-specific technical service. In a contract dealer system the coordination of the channel relations is regulated on the basis of the dealer contract. In addition to the dealer contract, the specific design of structures and business processes is regulated by guidelines (Diez, 2006, p. 282).

Moreover manufacturers can use their channel power as a coordination instrument to alter channel members' behaviour in order that they take actions they would not have taken otherwise. Manufacturers can draw on the following types of power to elicit cooperation: reward, brand, expert or coercive power. Reward power means, that the manufacturer can offer intermediaries an extra benefit for performing specific tasks or functions. Reward power typically produces better results than coercive power. Brand power means that the manufacturer is so highly respected that intermediaries are proud to be associated with him. Companies such as Porsche, BMW or SAP are examples for high brand power. Expert power of a manufacturer refers to his special knowledge of what the intermediaries value. This is for example the manufacturer's competence to steer the process of development, production and distribution of automobiles. Finally with coercive power manufacturers can threaten to withdraw a resource or terminate a relationship if intermediaries fail to cooperate. This power can be effective, but its exercise produces resentment and can generate conflict and lead the intermediaries to organise countervailing power. Coercive and reward power are objectively observable; contract and expert power are more subjective and depend on the ability and willingness of parties to recognise them (Diez, 2006, p. 282 f; Kotler et al, 2009, p. 638 f).

New channels of information and distribution can change power bases and opportunities. Therefore most companies see gaining intermediaries' or buyer supplier cooperation as a huge challenge. They often use positive motivators, such as higher margins, special deals, premiums, cooperative advertising allowances, display allowances and sales contests. Through the use of such instruments the contract dealer distribution system is safeguarded by the manufacturer against instabilities in addition to the contract (Diez, 2006, p. 282 f; Kotler et al, 2009, p. 638 f).

3.2.2 Characteristics of Dealer/Service Contracts and Standards

The basis of the relationship between automobile manufacturers and dealers is the dealer/service contract, which represents the formal framework of cooperation in the distribution channel. Distribution through contract dealers is a so called "selective distribution system". This means that automotive manufacturers can set qualitative and quantitative criteria for the selection of their distributors. Important qualitative criteria are for example the personal qualification of the owner and his employees, requirements regarding performance-related standards (e.g. stock keeping require-

ments, number of showroom cars) or to design the building and retail space according to the manufacturers' directives (Diez, 2006, p. 274).

Building and Site	Processes	Business Management
<ul style="list-style-type: none"> ▪ Corporate design and corporate identity standards ▪ Architecture ▪ Design and number of work places ▪ Size of customer parking lot ▪ Opening hours ▪ Workshop equipment and tools ▪ Etc. 	<ul style="list-style-type: none"> ▪ Keeping adequate spare parts inventory ▪ Service and warranty processes and complaint management ▪ Participating workshop test ▪ Participating CRM and market development programs ▪ Participating customer satisfaction analysis ▪ Etc. 	<ul style="list-style-type: none"> ▪ Standardized reporting and KPIs ▪ Participation in service benchmark studies ▪ Financial documents (strategic and operative business plan, annual financial statement, P&L, etc.) ▪ Minimum financial resources ▪ Etc.
Quality	Personnel	IT-Systems
<ul style="list-style-type: none"> ▪ Implementation quality management system ▪ Audits by OEM/Importer ▪ Etc. 	<ul style="list-style-type: none"> ▪ Job descriptions ▪ Personnel planning and recruitment standards ▪ Training and development plans ▪ Remuneration models ▪ Etc. 	<ul style="list-style-type: none"> ▪ Dealer management system ▪ Order processing system ▪ Electronic parts catalogue ▪ Warranty processing system ▪ Accounting system ▪ Etc.

Figure 8: Examples for Qualitative Standards set by OEMs in Car Service

Moreover, in order to limit the number of official dealers, manufacturers and importers carry out a further quantitative selection amongst those distributors who meet the qualitative criteria. This means that the number of dealers acting in the same sales territory can be restricted (EC, 2000, p. 10). The Block Exemption Regulation No 1400/2002 separates new car sales, repair, and parts supply. As a result of the split between new vehicle business and aftermarket business there are now separated contracts for car dealers with service and repair centres but also for stand-alone service and repair centres, so called authorized repairers.

With dealer selection on the basis of qualitative standards, these standards became part of the dealer contract. The dealer contract is very important in the context of behaviour coordination, since the compliance with these standards is linked with the remuneration of the authorized dealers. Beside the allocation of rights and duties between the contract partners, the definition of qualitative standards as well as the design of the margin and bonus system, are regulated in the dealer contract.

This drive for standards has taken place in parallel with the evolution in margin structures. While quantitative bonuses are an incentive system to achieve sales volumes, qualitative bonuses are an incentive to raise standards of facilities and the level of customer service (LE, 2006, p. 80).

4 The Competition Regulation Framework of Vehicle Distribution and Servicing in the European Union

The concluded contracts between companies in vertical marketing systems and the connected rights and duties are determined by different national and international regulations. In this context for the European automotive industry the European competition law with its specific Motor Vehicle Block Exemption Regulation is relevant and will be explained more in detail in the following section.

4.1 Introduction and Background regarding Competition Law

A general aim of the EC treaty is the creation of a common market by implementing policies which shall ensure that the competition within the internal market is not distorted (EC Treaty Article 2 and 3). Therefore the necessary competition rules were extended regularly over the last decades.

It is evident that the way how manufacturers organize their distribution networks with qualitative and quantitative selection criteria and the obligations which they impose on their dealers have anticompetitive effects (Creutzig, 2005, p. 129). Relevant in this context is Article 101(1) of the Treaty on the Functioning of the European Union (TFEU) which prohibits agreements that may affect trade between European Union countries and which prevent, restrict or distort competition and which applies to vertical agreements. Vertical agreements are agreements for the sale and purchase of goods or services which are entered into between companies operating at different levels of the production or distribution chain (EC, 2010). Agreements between car manufacturers and wholesalers or retailers regarding car distribution or vehicle repair are typical examples for such vertical agreements.

However there is an exemption from Article 101(1) TFEU for agreements which create sufficient benefits to outweigh the anti-competitive effects (Article 101(3) TFEU). Basically agreements can only be exempted if consumers receive a fair share of the benefits resulting from the improvements. Whether a vertical agreement actually restricts competition and whether in that case the benefits outweigh the anti-competitive effects will often depend on the market structure.

However, the Commission can also grant an exemption by regulation for whole categories of agreements. Such regulations are commonly referred to as "Block Exemption Regulations (BER)" and provide a safe harbor for most vertical agreements.

The BER renders, by block exemption, the prohibition of Article 101(1) TFEU inapplicable to vertical agreements which fulfil certain requirements. Block Exemption Regulations exist, for instance, for vertical agreements, R&D agreements, specialisation agreements, technology transfer agreements and car distribution agreements. For the motor vehicle sector the Commission has adopted a sector-specific Block Exemption Regulation (EC, 2002).

4.2 The Block Exemption Regulation for the Motor Vehicle Sector

The automotive sector is still different from markets for other types of goods. Buying a vehicle continues to be an expenditure which differs significantly from most other purchases, and proper servicing has implications not just on family budgets, but also on road safety and the environment. For instance cars need non-typical huge capital investment for dealer or repairer, whilst operating on very small margins, European availability for service and warranty, and European part availability. This explains the importance, attributed by the European Commission, to protecting conditions of effective competition for these particular goods in order to allow consumers to purchase vehicles at the best possible conditions of price and delivery and to enjoy the best possible conditions of post-sales assistance. Due to these particular characteristics a specific regulatory background regarding the vehicle sector emerged which was continuously reworked and fine-tuned by the European Commission over the last decades (CECRA, 2008).

The first exemption decision in the field of motor vehicle distribution and servicing agreements was the so called “BMW case” in 1974. Many car manufacturers continued to notify their agreements to the Commission in order to obtain individual exemption decisions. To solve this problem of handling a mass of individual notifications and to give more guidance and legal security to the car industry, the Commission decided to adopt a Block Exemption Regulation (MVBBER 123/85) along the lines set out in the BMW decision. This BER regulated the competition in the vehicle sector since 1985 for ten years (EC, 2000, p. 15).

In 1995, the Commission adopted a new Block Exemption Regulation (MVBBER 1475/1995) for motor vehicle distribution and servicing agreements, which was accompanied by an explanatory brochure entitled “Distribution of Motor Vehicles (Mendelsohn, 2002, p. 137). Although the basic principles of Regulation 123/85 remained unchanged the Commission amended the formal regulation on the basis of

the experience it had gained with its application and also in response to complaints it had investigated. The adjustments are aimed at improving the functioning of an internal market in cars and intensifying competition at the stage of car distribution by re-balancing the various interests involved, in particular by strengthening the dealers', spare-part producers', independent repairers' and consumers' rights and freedoms (EC, 2000, p. 20).

Commission Regulation 1475/1995 expired on 30 September 2002 and was replaced by Commission Regulation 1400/2002 of 31 July 2002. The new Regulation introduced a number of substantial changes as regards the exemption of distribution agreements for new motor vehicles and spare parts. It also introduced major changes as regards the exemption of agreements for the provision of repair and maintenance services by authorised and independent repairers and other independent operators, such as distributors of spare parts and providers of training for repairers (EC, 2002, p. 8).

EU competition rules changed again on 1 June 2010. Since that date, the new automotive Block Exemption Regulation 461/2010 applies to agreements regarding the provision of repair and maintenance services and the sale of spare parts. Agreements regarding the sale of new motor vehicles continue to be governed by the old automotive BER 1400/2002 for a transition period until 31 May 2013. Subsequently, they will fall under the general BER 330/2010 for vertical agreements (ACEA, 2011).

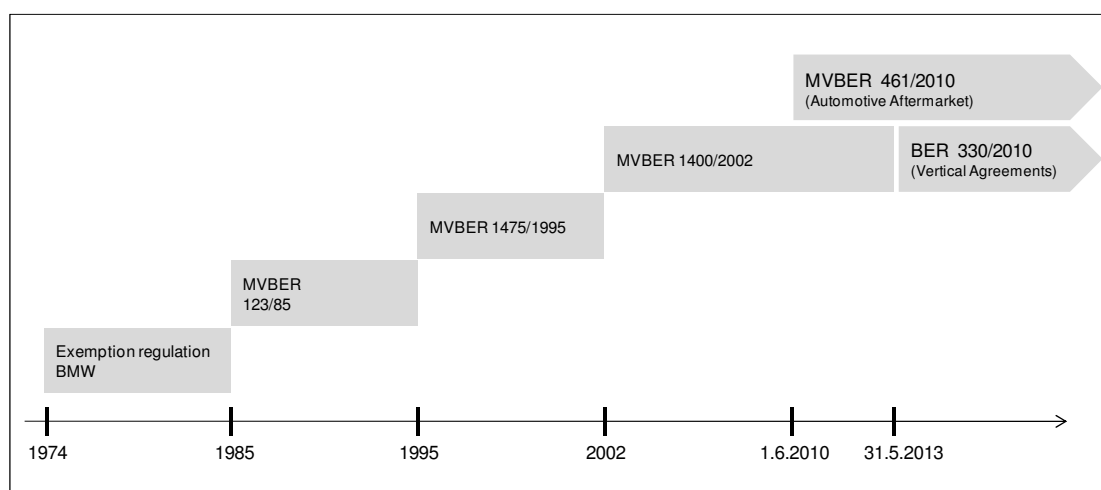


Figure 9: Development of Block Exemption Regulation in the Automotive Sector

4.2.1 Actual Competition Law Framework

The European Commission concluded from its assessment of the impact of the Block Exemption Regulation 1400/2002 in 2008 that the industry had evolved and that an extension of the BER in its current form was not necessary (EC, 2008). For the distribution industry it concluded that there did not appear to be any competition shortcomings that distinguished it from any other sector abiding by the general competition rules for vertical agreements. Consequently, it was assumed that a BER for the distribution industry is no longer needed. However, for the aftermarket industry it was deemed necessary to keep a BER due to its specific characteristics (Deloitte, 2011, p. 4). The distinction between the markets for the sale of new motor vehicles and the motor vehicle aftermarkets shall reflect the differing competitive conditions on these markets (EC, 2010a). In the following an overview of the major changes in the legislation for both distribution and aftermarket is given.

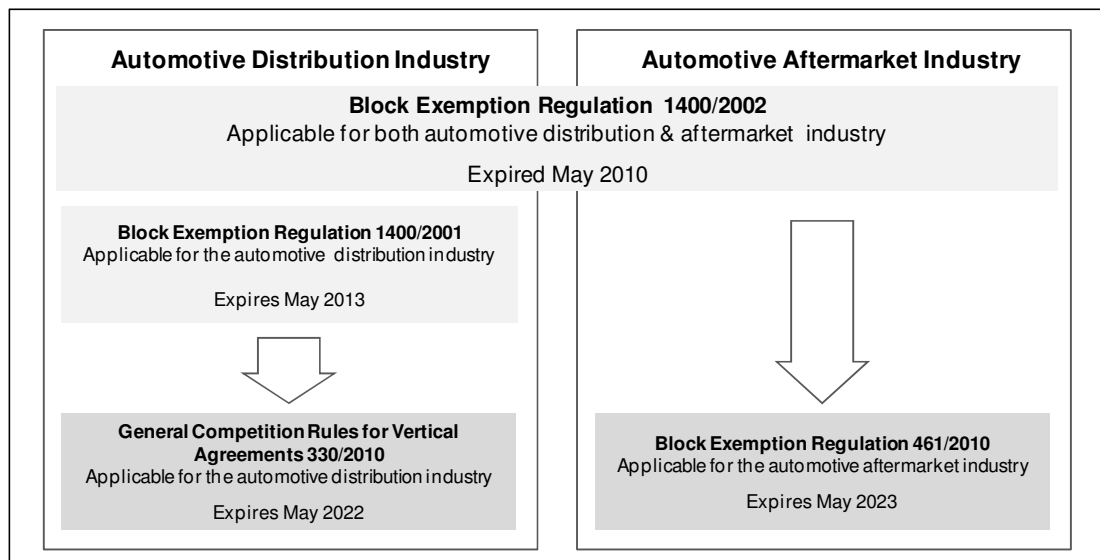


Figure 10: Competition Law Framework for the Automotive Industry: Split between Distribution and Aftermarket Industry (Deloitte, 2011, p. 5)

4.2.1.1 Regulations for New Car Distribution

Exclusive versus selective Distribution System

After 2002 the Block Exemption Regulation forces the manufacturer to decide between selective or exclusive distribution. In a selective distribution system, the manufacturer can impose qualitative criteria, such as dealership layout, for the dealer to become authorized. In an exclusive distribution system the manufacturer can apply quantitative criteria, number of dealers per region, and limit the number of authorized dealerships. The idea behind was the reduction of price differentials across the

EU but also encouraging diversity in distribution systems. All car manufacturers, with the exception of Suzuki, adopted a selective distribution system (LE, 2006, p. xx). In a selective distribution system manufacturers still have the possibility like under BER 1475/1995 to select their distributors according qualitative and quantitative criteria¹.

The European Commission realized that this regulation did not have the desired effect, as the OEM could use the selection criteria within a selective distribution system to control its distribution network, and rationalize it even further. As the European Commission concluded that the dealer networks were competitive enough, it had no concerns with the possibility to impose again both qualitative and quantitative standards (Deloitte, 2011, p. 6).

Prohibition of the “Location Clause” in Sales and Service

After 1 October 2005 the prohibition of the “location clause” allowed dealers to open additional sales or delivery outlets in other areas of the Common Market in order to exploit new business opportunities but also to reduce price differentials between the different European markets (EC, 2002, p. 33). However the manufacturers could exert influence through the definition of the standards such outlets have to meet and may require the additional outlets to comply with the quality standards applicable to the outlets of the same type in the same geographic area. The European Commission concluded there was sufficient cross border competition without secondary sales outlets being set up in other European countries. Consequently under BER 330/2010, OEM’s can again prohibit additional sales outlets by reintroducing a “location clause” (Deloitte, 2011, p. 6).

Break in the “Natural Link” between new Car Sales and Service

Under BER 1400/2002 car manufacturers cannot impose an obligation on car dealers to carry out repair and maintenance services any more (“Obligation to contract”). Nor is a manufacturer allowed to oblige its authorized repairers to distribute new motor vehicles. New car sales and maintenance services are regarded as separate business segments which made, as already mentioned, a contractual separation of sales and service necessary (Diez, 2006, p. 278).

¹ “However, the market share threshold for the application of the exemption shall be 40% for agreements establishing quantitative selective distribution systems for the sale of new motor vehicles” (Art 3(1) MVBBER 1400/2002).

A consequence of imposing the general rules for vertical agreements is the fact that a dealer can again be requested to provide after sales services, which was not the case with the previous BER in 2002. This will however have a limited impact as the majority of dealers want to provide after sales services since this is usually the most profitable business (Deloitte, 2011, p. 6).

Multibranding

BER 1400/2002 seeks to ensure access to markets and to give distributors and repairers in particular opportunities to sell and repair vehicles from different suppliers, i.e. “multibranding” (EC, 2002, p. 31). Article 1b of BER 1400/2002 regulates this right of the dealer and instructs the dealer only to sell motor vehicles from other suppliers in separate areas of the showroom in order to avoid confusion between the brands.

The application of the general rules for vertical agreements will also bring some changes and restrictions for dealers operating a multibrand strategy. With BER 330/2010 the OEMs have for example the possibility to require sales percentages up to 80 per cent of a dealer’s yearly total sales (Plate, 2010, p. 14). An OEM has also the possibility to hinder a dealer to operate a multibrand business model within the same showroom (Deloitte, 2011, p. 6).

4.2.1.2 Regulations for the Automotive Aftermarket

Concerning the aftermarket industry the European Commission concluded that the current industry was not competitive enough and still needed sector specific regulations to make the aftermarket competitive to the benefit of the consumer. This resulted in the new BER 461/2010 which regulates the aftermarket for spare parts, repair and maintenance and which was introduced on 1 June 2010 (Figiefa, 2010, p. 1). The regulations of BER 1400/2002 regarding the aftermarket were more or less retained without major modifications. But the main aim of the European Commission was to clarify any ambiguities and to enforce the regulations more tightly in the future (Deloitte, 2011, p. 7). The regulation seeks to maintain consumers’ freedom of choice where maintenance and repair are concerned. Furthermore the regulation sets out to ensure that authorized dealers have more commercial freedom to buy parts from the independent market. This means that car manufacturers cannot require their authorised dealers to buy parts from the car manufacturer’s supply network.

Selective Network

For the aftermarket industry still, like under BER 1400/2002, only a selective network is permitted. As opposed to the distribution industry no quantitative criteria can be set. This means that any repairer who meets the selective criteria can become an authorized repairer (Deloitte, 2011, p. 7). Regarding spare parts also the obligation of authorized repairers to purchase at least 30 per cent of the spare parts from the OEM is not applicable any more (Plate, 2010, p. 14).

Introduction of the Concept of stand-alone authorized Repairers - Obligation to Contract

Also contrary to the distribution industry, since 2002 the OEM's cannot oblige the repairer to distribute cars. Past research concluded that consumers are prepared to travel longer distances for the actual purchase, compared to the distance they need to travel for the servicing. Consequently it would make little sense for OEM's to impose extra costs on the repairers if they are not able to make a profitable business from the distribution of cars (Deloitte, 2011, p. 7).

Alternative Sourcing of Spare Parts and Access to technical Information

Alternative sourcing of spare parts must be possible for authorized dealers and repairers. Following the former Block Exemption Regulation 1400/2002, the new competition law framework confirms that vehicle manufacturers may not hinder their original equipment suppliers from also supplying their products as spare parts to independent distributors or directly to independent or authorized repairers (Figiefa, 2010). Both direct sourcing from the OEM's suppliers as well as the sale of spare parts from authorized repairers to independent repairers needs to be possible (MVBBER 461/2010, Article 5(a),(b)). Another important element is the equal access to technical information for both independent and authorized repairers (Deloitte, 2011, p. 7).

Moreover restrictions in a vertical agreement concluded between a motor vehicle manufacturer and a spare parts manufacturer by which the spare parts manufacturer is not allowed to state its logo or trademark on the parts supplied for initial assembly in the vehicle manufacturer's factory, are illicit (MVBBER 461/2010, Article 5(c); cecra.eu).

Repair during the Warranty Period

In its explanatory brochure on the MVBBER 1400/2002, the European Commission had introduced an important clarification that independent repairers may carry out regular maintenance service and repair jobs during the warranty period. This issue was clarified further that servicing or maintenance performed by an independent repairer cannot be a reason for the warranty to expire (Figiefa, 2010, p. 10, Deloitte, 2011, p. 7).

Implications on the Designing of a Margin and Bonus system

Under the former BER it was possible to remunerate the dealer based on his sales performance in a particular territory measured for example by market exploitation. This is not allowed anymore because the sales territory of a dealer in a selective distribution system is the whole Common European Market (EC, 2002, p. 49). Therefore the territory allocated to a dealer cannot be used as a steering variable any more. In connection with the right to open additional outlets the BER imposes certain restrictions regarding the margin and bonus system. The manufacturer is not allowed to base bonus systems or other kinds of financial or nonfinancial incentives on the buyer's place of residence or establishment, or on the place where the vehicle is to be registered (EC, 2002, p. 48 f; MVBBER 1400/2002, Recital 16). The contractual separation of new car distribution and aftermarket services did not only increase the administrative effort in coordinating the sales and service network, but induces also changes in the margin and bonus system. Under the BER 1475/1995 it was common practice to combine standards of customer satisfaction related performance from sales and service in a bonus system, which is no longer allowed (MVBBER 1400/2002, Recital 22).

5 The Automotive Aftermarket

5.1 Introduction and Definition

The aftersales service covers all activities which are necessary for supporting and securing the use of an automobile. Regarding the automotive industry this includes providing technical services (repair and maintenance) on the vehicle as well as supplying customers with spare parts (Diez, 2006, p. 176). The Automotive Aftermarket Industry Association (AAIA) defines the automotive aftermarket as consisting of products and services bought after the original sales of the vehicle, including replacement parts, accessories, lubricants, appearance products, service repairs, and the tools and equipment necessary to do repairs.

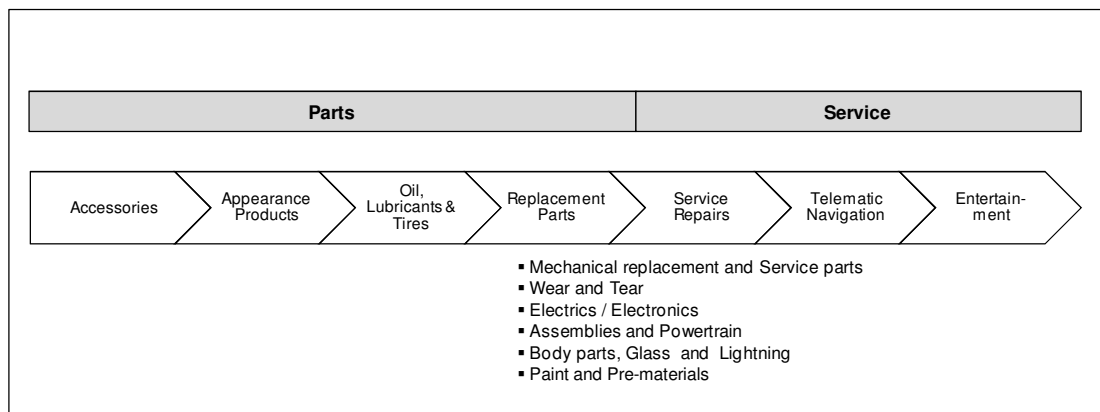


Figure 11: Main Components of the Automotive Aftermarket (adapted from Capgemini, 2010, p. 6)

The automotive aftersales market is huge and delivers outsized profits. These bottom-line results are why players focus intently on this segment of the global automotive industry (McKinsey, 2011, p. 1).

With global revenues of € 530 billion, this market accounts for about one fourth of the entire global automotive market (passenger cars, including related services such as aftersales, insurance and leasing) (McKinsey, 2008, p. 5). In the European Union the volume of the automotive aftermarket was around € 190 billion in the year 2010 (Auto & Wirtschaft, 2011, p. 72), thereof the automotive spare parts market generates € 96 billion returns for original equipment manufacturers and their original equipment suppliers (McKinsey, 2011, p. 1). The Western European automotive aftermarket for service and parts can be described as a mature market with high competitive pressure and rather flat volumes.

5.2 Importance of the Automotive Aftermarket Business

The aftersales service is very important for the market performance of automobile manufacturers due to several reasons. From the vehicle customer's point of view the technical service is of high importance when buying and using a car, as the provision of technical service is a necessary complementary offer of the OEM which goes along with the new car sale (Diez, 2006, p. 176).

Moreover the aftersales service is an important instrument for competitive differentiation, brand and loyalty building for OEMs. As surveys of the consulting Company J.D. Power have shown, customer satisfaction depends to 60 per cent on the quality of the vehicle and to 40 per cent on the quality of the service (Diez, 2006, p. 176). Regarding parts business a high service level to guarantee high availability of spare parts is necessary to meet increasing customer expectations. Good service is one of the most important attributes affecting whether customers stay loyal to the brand for subsequent purchases and is therefore one of the most important drivers of new car sales (McKinsey, 2008, p. 13).

Finally the aftersales service constitutes an important source of value creation which generates stable revenue streams at higher profit margins for OEMs and their car dealerships. As already shown in figure 5 the downstream business is generally more profitable with higher margins compared to those in other market segments, especially with regards to production and new car sales. A benchmarking study conducted by The Boston Consulting Group of 50 manufacturers that also provide after sales services confirmed the attractiveness of service businesses for industrial good companies. On average, the service business of the companies in the sample accounted for about 30 per cent of their revenues and contributed more than 50 per cent of their total operating profits, at a profit margin of 24 per cent. Among the top-quartile companies, services contributed an average 47 per cent of revenues and earned average profit margins of 36 per cent (BCG, 2009, p. 1). Especially the parts business is under profitability aspects of high significance to automotive manufacturers and their dealers.

In general the service business is cyclically more stable than new car sales business which nowadays makes only a small contribution to profits. The need to increase customer incentives has led to a consequent erosion of margins in the car dealers' core business and to a mediocre average return on sales between 0 per cent and 1.5 per cent (Arthur D. Little, 2008a, p. 1; Oliver Wyman, 2009, p. 20). Since OEMs

and dealers are experiencing declining profit margins from new car sales, they are increasingly dependent on the aftermarket as a source of corporate profit (LE, 2006, p. 265).

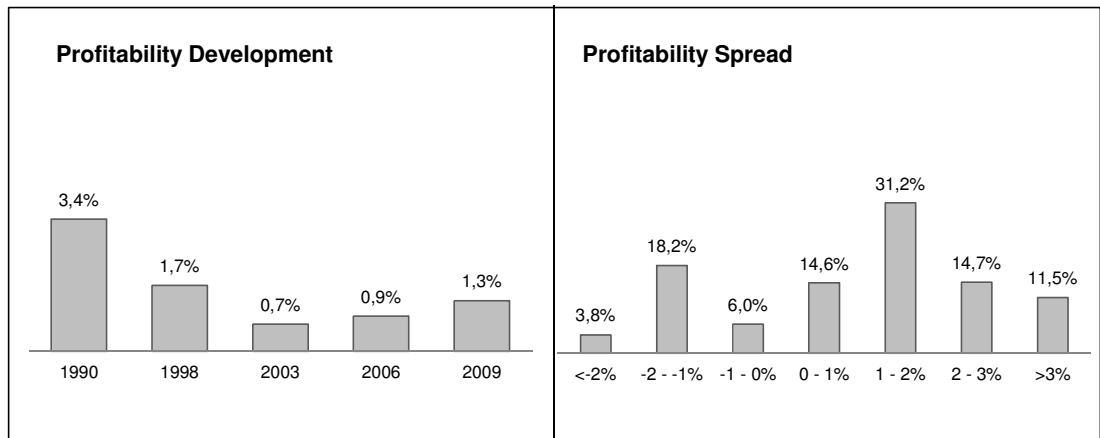


Figure 12: Deteriorating Profitability in Car Retail, Example Germany (Arthur D. Little, 2008a; Autohaus 02/2010)

5.3 Structure of the Automotive Aftermarket

Figure 13 describes the overall aftermarket value chain and distribution channels and characterizes the typical players on the different levels (McKinsey, 2008, p. 13).

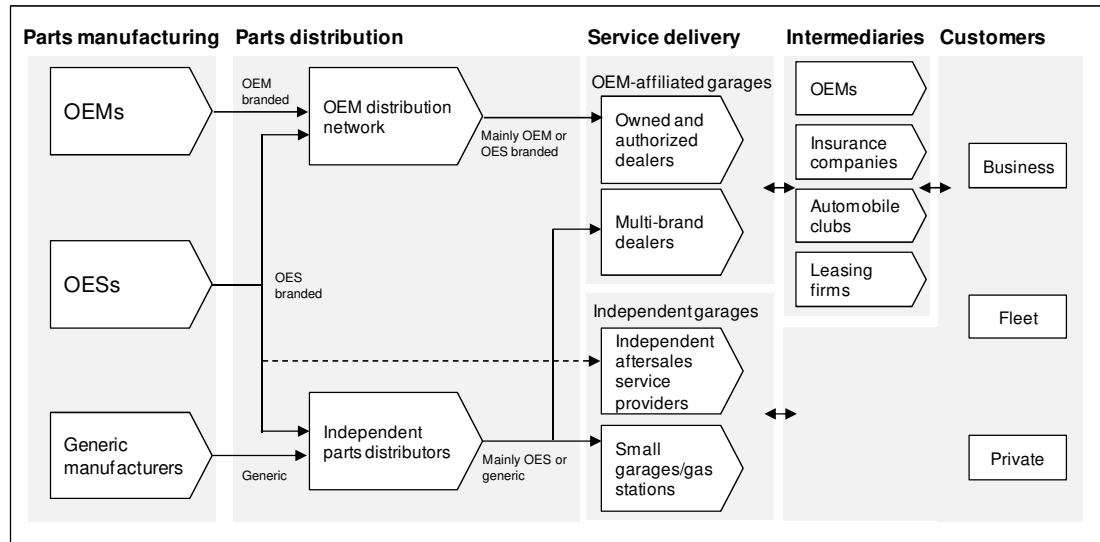


Figure 13: Structure of the Automotive Aftersales Market – Typical Players (Mc Kinsey, 2008, p. 13)

The aftersales revenue is basically divided between two main providers which are on the one hand the OEMs with their authorized dealerships and on the other hand the companies which are independent from the car manufacturers. OEMs typically participate in all three areas of the value chain, including manufacturing parts, selling and distributing them, and delivering service through authorized dealer networks or company-owned facilities (McKinsey, 2008, p. 14, LE, 2006, p. 132). Important advantages for OEMs and their authorized repairers are mainly the brand value and being able to guarantee the products and services, and therefore they have the ability to capture a large market share among the new-car owners of the respective brand (LE, 2006, p. 132). In many mature automotive aftersales markets, with the exemption of North America, the OEMs are still predominant with more than 50% market share (Arthur D. Little, 2008, p. 1).

The independent repairers, that is, repairers without a franchise contract with a vehicle manufacturer, come in very different shapes and sizes; from one-man corner shops to multinational networks and cover a wide range of businesses in terms of the type of work they undertake (LE, 2006, p. 132, 149). The following types of outlets can be distinguished: Fast fit chains, which offer a lean service for passenger cars. They mostly offer tires including service and may also provide brakes, exhausts, oil, shock absorbers and air conditioning. Then there are garages which are

specialized in specific car repairs (auto glass, body and paint shops, tire specialists, specialists in electrics/electronics, etc.). Independent stand-alone workshops which are also often affiliated to franchised systems. Such garage marketing or franchised systems are mainly run by wholesalers or parts manufacturers. They are divided into two groups: the full service system which offer a complete service for all brands and the product oriented systems which are specialized in single product groups. Most of such franchise systems are based on partnership contracts and are only in a few cases based on “real franchising”. Finally there are also petrol stations offering aftermarket service and products (Wolk & Partner, 2010, p. 16 f; Diez, 2006, p. 181 f). All these market participants work at the retail end of the after sales value chain, providing repair service to private customers and company fleets.

5.4 Developments and Challenges in the Aftermarket Business

A number of factors influence the market for aftersales services and are changing the landscape. The stagnating new car registrations, aging car parks and the trend to downsizing result in a decrease of the repair potential. Due to further deregulation OEMs are facing more intense competition resulting in higher marketing cost and shrinking profit margins also in the aftermarket business. Other sources of pressure are the increasing sophistication of aftersales customers in terms of needs and expectations, a higher price transparency as well as the increasing share of customers willing to switch to other providers (McKinsey, 2008, p. 8).

Competition	Car Park Evolution	Repair Potential
<ul style="list-style-type: none"> ▪ OES activities increase ▪ Independent spare parts aftermarket ▪ Partner and franchise concepts grow ▪ Repair chains with aggressive marketing – price competition ▪ Internet as a sales channel emerges ▪ Increasing influence exerted by intermediaries 	<ul style="list-style-type: none"> ▪ Stagnating new car markets in mature markets ▪ Parts business performs below average ▪ Aging pool of cars - more and more cars in later lifecycles ▪ E-mobility and new mobility concepts (e.g. car sharing) 	<ul style="list-style-type: none"> ▪ Decreasing service needs/vehicle ▪ Decreasing vehicle repair ▪ Decreasing warranty repairs ▪ Downsizing vehicles ▪ Decreasing annual mileage performance/car
Customers Needs	Relationship OEM - Dealer	Legislation
<ul style="list-style-type: none"> ▪ Fragmentation of customer behaviour ▪ Differentiation of customer segments with specific requirements ▪ Smart shoppers ▪ Price sensitivity ▪ Increasing share of business and fleet customers 	<ul style="list-style-type: none"> ▪ Less contractual binding possibilities and contractual purchase obligations ▪ Bypass and third party sourcing possibilities ▪ Decreasing purchase loyalty of authorized dealerships 	<ul style="list-style-type: none"> ▪ Increasing influence from regulatory changes – especially for spare parts ▪ BER Block Exemption Regulation ▪ Repair clause ▪ CO2 emission standards

Figure 14: Developments and Challenges in Automotive Aftersales Business (Oliver Wyman, 2009, 2010; Arthur D. Little, 2008, 2008a,b; McKinsey, 2008)

In the following the most important trends in service and parts business, which are affecting the OEM's market share, sales revenues and profits will be discussed:

In Western Europe competition significantly intensified across the entire range of the value chain and will be further accelerated by new competitors which enter the market with innovative business models (Capgemini 2010, p. 8). In recent years, the automotive aftersales landscape has become increasingly more complex - especially since the EU's 2002 Block Exemption Regulation reform concerning the automotive industry - with players aggressively expanding in their core field or pursuing forward/backward integration solutions. An important change is the drive by former stand-alone independent repairers to become part of large repairer groups and thus having the possibility for achieving competitive advantages. Fast fitters usually conduct aggressive marketing campaigns and tend to place from two to six times as many advertisements as OEMs. In these ads they clearly emphasize low prices, flat-rate and high-value offerings (LE, 2006, p. 162; McKinsey 2008a, p. 2, 13 f).

Also the internet is emerging as a retail channel for parts and services, enabling the sale of low price parts and service. Repair auctions and other business models might steer the flow of customers in the future, like it already happens today in the used car business (Arthur D. Little, 2008, p. 2). According to the opinion of IFA-director Willi Diez this will particularly apply to standardized service and repair works. Some examples are www.repcar.de which tenders repair orders for body shop works, the address-database www.motoso.de sells fix-price offerings and the online platform www.autohelden.de tenders workshop orders via reverse auction (John, 2011, p. 28). Due to such internet offerings workshops have to face more price transparency which gradually might also put high after sales margins at risk. In Germany, for example, two websites for price comparisons will be launched by the end of year 2011 (www.werkstatt.autoscout24.de) www.fairgarage.de (Automobilwoche, 2011, p. 8).

Another source of uncertainty is customer behaviour, which shows also in the car service a strong trend to multi-optionality and fragmentation. The share of those customers who are prepared to have some works on their cars executed elsewhere than in the authorized workshops, has increased significantly. Regarding small repairs this proportion is with 65 per cent particularly high. The main reason is dissatisfaction of customers with the price and generally increasing price sensitivity in this area can be observed (Diez, 2006, p. 178). Smart shopping has become a discipline

that shapes every purchase a buyer makes. Smart shoppers trawl multiple sources to retrieve copious information about products and market prices. Ever keen to secure the best value for money, they tend to shrug off the influence of past purchasing decisions. This undermines customer loyalty, forcing vendors constantly to create attractive new offerings (Kalmbach, 2007, p. 33).

OEMs and their authorized workshops are also put under pressure by intermediaries, such as leasing or insurance companies, which have considerable buying power. Car insurers keep professionalizing and optimizing their claims management by routing the costly accident-repair business to their preferred repair networks at the expense of brand dealerships. Under the term “accident routing” they are seeking to reduce repair costs by exerting pressure on the prices charged by authorized repair shops (Diez, 2006, p.180; Oliver Wyman, 2009, p. 21).

Beside high competitive pressure, and uncertainty of customer behaviour, it has to be taken into account, that the market for service and repair in mature markets is expected to stagnate over the next years or shows even a declining trend. In Germany, for example, the average maintenance frequency per year and car has declined from 1.5 in the 1980ies to 0.9 in the year 2010. Also the repair frequency decreased in the same period from 1.4 repairs per year and car to 0.77 by now (DAT-Report, 2011, p. 36 f). The declining demand in automotive service can be attributed to the technical progress and the resulting increased vehicle quality. This has led to a longer vehicle lifetime as well as to extended service intervals (Diez/Reindl/Brachat, 2005, p. 441).

Modern Passenger cars exhibit fewer breakdowns and require fewer inspections due to more robust vehicle design, better metallurgy, and improved fluids and lubricants. Today’s cars only need maintenance every 30,000 kilometers or more (and even then, procedures involve fewer parts changes than in the past), feature lubricated-for-life chassis components, and have extended-life axle and transmission lubricants. The next-biggest inhibitor arises from the positive trend of fewer accidents, owing to government action and also because of increased safety equipment, which ultimately means lower demand for body shop repairs. This trend mainly affects specialized garages as well as authorized outlets, which dominate the body shop repair subsegment (McKinsey, 2008, p. 15, Blanchet/Rade, 2007, p. 185).

In addition it has to be noted that in the long term the annual miles performance per car has been declining significantly which affects the wear-and-tear on a car and, as a consequence, the need for aftermarket works (Polk, 2009, p. 2). In Germany the average travelled kilometres fell from 15,300 in the year 1970 to 10,845 by now (figure 15) (Diez/Reindl/Brachat, 2005, p. 27; VCÖ, 2011).

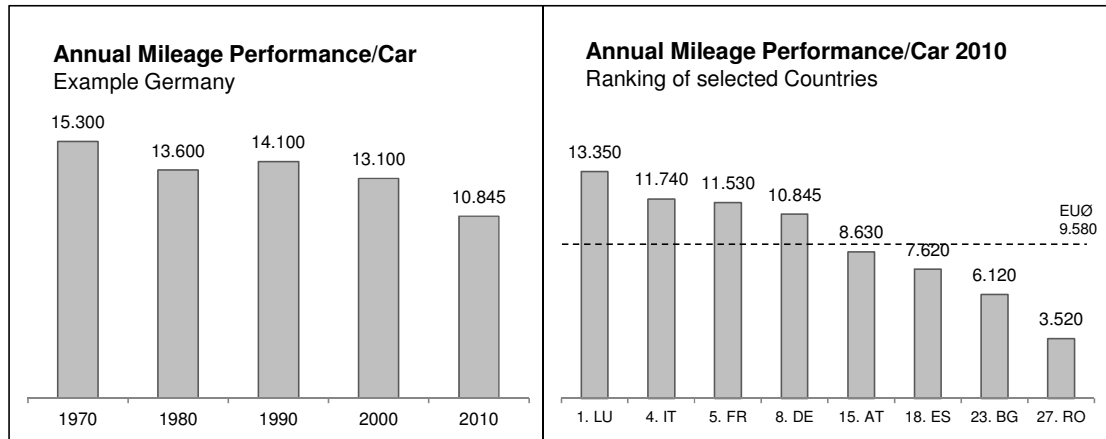


Figure 15: Annual Mileage Performance per Car (adapted Diez/Reindl/Brachat, 2005, p. 27; VCÖ, 2011)

Higher quality of the vehicles and less driving performance lead to a steady increase of vehicle holding periods and to an aging car park. This is important to note, since the most relevant factor determining whether a car is repaired by an authorized repairer or an independent workshop is the car's age. The car repair and service expenditures profile is shifting along the car lifecycle. This pattern is consistent across countries.

Figure 16 shows an example from Germany. It shows clearly that the overwhelming majority of new cars is serviced and repaired by the authorized providers, and that the market share of the authorized segment declines steadily with the age of the car, while the opposite is true for independent repairers. This pattern is largely the same for repairs and service jobs (LE, 2006, p. 133). Today OEMs capture on average 85 per cent of owners of cars up to four years old, but customer loyalty drops to just 33 per cent for cars aged more than eight years (DAT-Report, 2011, p. 46). This development is influenced by the increasing price sensitivity of owners of older cars and the image of OEM dealers to deliver high-quality service but being too expensive, whereas independent repairers are perceived by customers for their low price image (Diez, 2006, p. 178; Blanchet/Rade, 2007, p. 185).

To reduce the customer migration to independent workshops and strengthen loyalty to authorized dealers, OEMs already started introducing life-cycle based service

offerings. Drivers of older cars are interested in a time-value compatible supply, meaning that the value of the parts installed must be proportional to the residual value of the vehicle. Entering the market with a second parts brand or own garage formats with specific service offerings allows the OEMs to target and regain such customers that do not use the OEMs' own aftersales channels. Vehicle Manufacturers like Citroen and Renault have decided to create their own network of multi-brand repair centres with the brand names Eurorepar and Motrio. As shown in figure 16, these customers represent a growing potential market in older car segments.

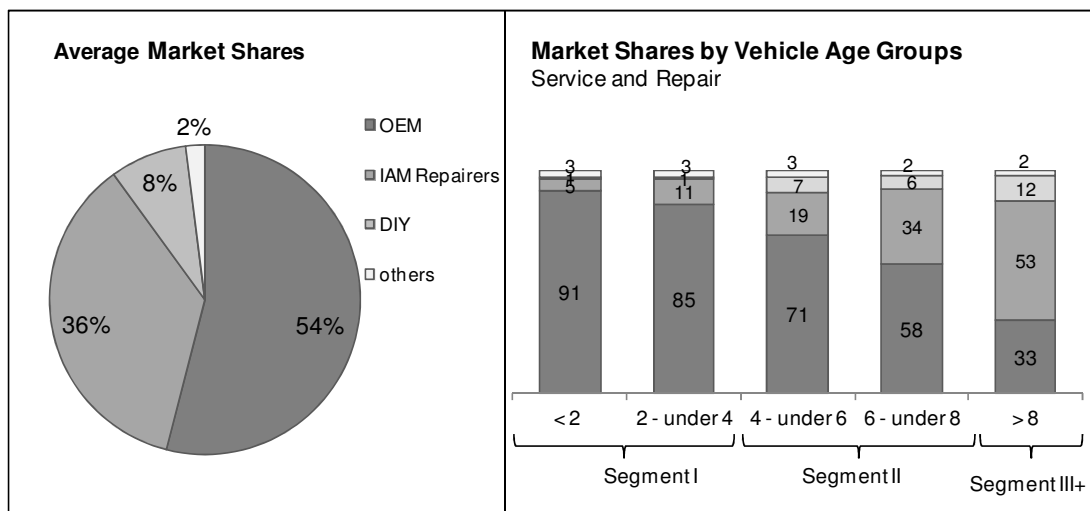


Figure 16: Market Shares of Types of Repairers and Vehicle Age Groups (DAT-Report, 2011, p. 46)

Especially parts which are suitable for differentiation on quality, such as wear-and-tear parts, are appropriate for the second parts brand (Arthur D. Little, 2008b, p. 2 f). Nearly all OEMs offer also remanufactured parts as a residual-value alternative to new parts. The assortment of Volkswagen for example comprises about 14,900 parts which are up to 50 per cent cheaper than new parts (Ziegler, 2011, p. 12). But it is still a challenge for manufacturers to balance profits and pricing and achieve a higher service loyalty over the 10 year lifecycle of car ownership (Kroll-Thaller, 2010, p. 45).

These OEM strategies are increasingly important as, already mentioned, the average age of the car park has been increasing over the years. In Austria, for example, the average age of a passenger car increased from 8.7 years in 2005 to 9.1 years in 2010. Already today more than half of the total passenger car park is older than 8 years (Statistik Austria, 2011). Moreover in the middle and long run new car registrations are expected to stagnate in mature markets with already high car density rates like Western Europe (Diez, 2010, p. 33). There is also a trend towards downsizing to smaller cars, particularly apparent as a result of the crisis in 2008. New car buyers,

also attracted by government incentive and scrappage programs, primarily purchased smaller, more affordable cars with less potential in the downstream business.

Brand	Second Parts Brand	Price Advantage (approx.)	Second Service Chain Brand	Remanufactured Parts
Citroen	Eurorepar	25%	x	x
Ford	Motorcraft	20%-30%		x
Kia	2 nd Line	20%		
Peugeot	Eurorepar	25%		x
Renault	Motrio	30%	x	x
Toyota	Optifit	25%		x
Volkswagen	Economy Parts	25%		x

Figure 17: Examples of OEMs who adopted a Second Parts Brand Strategy (Ziegler, 2011, p. 13)²

Also new technologies and mobility patterns will have an impact on service business. For example, electric vehicles offer fewer aftersales potential. It is estimated that an E-car will spend 120 hours in a workshop whereas for cars with conventional drive propulsion systems a decrease from 193 to 149 hours is expected (Eurotax-Glass No. 2088, p. 11). There are also a lot of developments which will affect the future mobility requirements, especially of the urban population. What can already be seen now, is, that the foundation of the car's position as a status symbol is eroding, and people no longer consider car ownership to be a necessity of life. In the downtown areas of German cities, for instance, only 80 per cent of people who are 18 to 29 years old have a driver's license. In rural regions, the total is 90 per cent. For the under-30 generation in Europe today, owning a car is already unpopular. They prioritize other things, rate usage higher than ownership and are paving the way for alternative mobility models. According to estimates, the market volume for car sharing in the United States and the 10 largest western European countries will total some EUR 4 billion by 2015 (Oliver Wyman, 2011, p. 9, Spiegel No. 45, p. 154).

² VW's service brand Stop+go was bought in the course of a management buyout (MBO) by former managers of the company (Autohaus online, 2011)

5.5 Automotive Spare Parts Business

5.5.1 Definition of Original Spare Parts

The revised Block Exemption Regulation 1400/2002 brought a new definition of the term original spare part. Hence original spare parts are thus no longer defined with regard to the vehicle manufacturer's distribution system, but rather their definition as original spare parts depends on quality and technical specification of the components. In this context it is important to note, that also oil is regarded as a spare part (Diez, 2006, p. 180).

„Original spare parts” means spare parts which are of the same quality as the components used for the assembly of a motor vehicle and which are manufactured according to the specifications and production standards provided by the vehicle manufacturer for the production of components or spare parts for the motor vehicle in question. This includes spare parts, which are manufactured on the same production line as these components. It is presumed, unless the contrary is proven, that parts constitute original spare parts if the part manufacturer certifies that the parts match the quality of the components used for the assembly of the vehicle in question and have been manufactured according to the specifications and production standards of the vehicle manufacturer (BER 1400/2002, Art. 1, (t)).

According to the BER there are three categories of spare parts that count as “original spare parts” (LE, 2006, p. 188 f):

Spare parts produced in-house by vehicle manufacturers themselves. Vehicle manufacturers may require their authorised repairers to use this category of original spare parts for repairs carried out under warranty, free servicing and vehicle recall work, but may not limit the right of their distributors to sell this category of parts, actively or passively, to independent repairers which use them for the repair and maintenance of motor vehicles.

Spare parts produced by spare parts manufacturers and sold to vehicle manufacturers who distribute them via their authorized partners. The same conditions apply to these parts as to spare parts produced by OEMs. In addition, a vehicle manufacturer may require the use of its logo on the parts distributed via its channel; however, the spare parts producer may not be hindered from using its own trademark either. Moreover, spare parts producers may not be prevented from supplying these spare

parts to any authorized or independent distributors or the authorized or independent aftermarket, nor may authorized repairers be restricted from using them.

Spare parts, manufactured by spare parts producers (whether or not they are OE suppliers), which are not sold to vehicle manufacturers, but which are manufactured according to the specifications and production standards provided by the vehicle manufacturer. These parts are supplied either via authorized or independent parts distributors or directly from parts manufacturers to the authorized or independent aftermarket. Again, authorized repairers may not be restricted from using them. Parts belonging to this category, of course, bear only the trademark of the spare parts producer.

So if, for example, parts producers supply one and the same shock absorber to both a vehicle manufacturer and an independent parts distributor, the product distributed to the independent market must also be considered an “original” spare part under the new BER (LE, 2006, p. 195).

5.5.2 Characteristics of Spare Parts Business

In the parts business the challenge for the auto industry lies in its gigantic range of parts with hundreds of thousands of different items. Due to the increasing number of different variants, complexity of vehicles and product categories, the on-going reduction of innovation and product life cycles as well as extended parts warranty periods, the width of the spare parts assortment has grown rapidly.

After the end of the product life cycle, the supply of spare parts has to be provided for the entire lifetime of the vehicle. For legal reasons automobile manufacturers are obliged to support older vehicles, out of production but still in operation, for up to ten years. Normally the vehicle manufacturers secure parts supply in addition up to 15 years after end of production (EOP), depending on vehicle models and types (Klug, 2010, p. 447 f). With thousands of different parts per car, the volume and complexity is enormous, involving multiple sources such as the cataloguing of hundreds of thousands of parts references and providing detailed information to the workshops in the dealer network about which parts fit which vehicle and how to fit them. Huge logistics are necessary to store parts and distribute them to dealers. Every part has to be priced and there are a large number of parts to be kept in stock for fast delivery to dealers in case of repair.

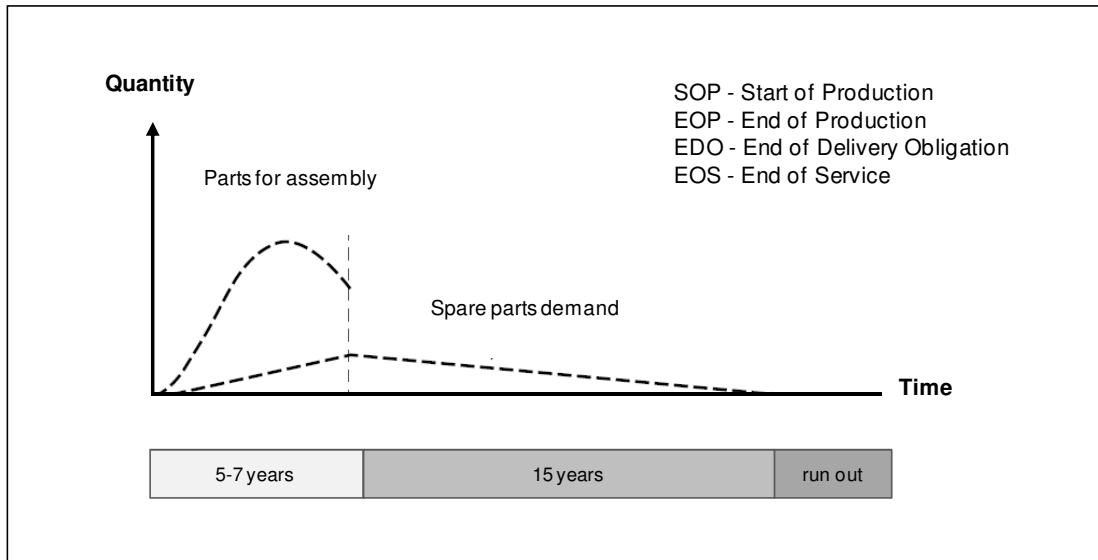


Figure 18: Development Spare Parts Demand (Klug, 2010, p. 448)

The right balance has to be found between maximizing local availability and minimizing the costs of carrying parts inventories in the distribution chain. Every day, the order flow comes from dealers with the majority of parts to be delivered the coming day to provide fast service to the customer (Kroll-Thaller, 2010, p. 93; Maxton/Wormald, 2004, p. 174). Some manufacturers ensure delivery even on the same day. Surveys regarding the technical service in the car dealership have shown that speed and adherence to schedules are beside the price most important drivers of customer satisfaction. Since a defective part can only be discovered during a current inspection or repair of a vehicle, flexible and fast logistic systems for spare parts are very important (Diez, 2006, p. 359 f).

When analyzing spare parts with respect to special characteristics, unit price, relative sales volume and consumption history, it can be seen that there are big differences between one another. One of the best known and most frequent tools for parts classification is the ABC analysis. Aim of this analysis is to determine the value proportion of stock keeping units (SKUs) as well as their periodical consumption. ABC analysis regarding spare parts and their respective turnover show almost always a significant concentration curve, so called Lorenz curve (Klug, 2010, p. 458). This means that a large proportion of the turnover is generated by only a small part of the assortment. Figure 19 shows an example of an OEM where 80 per cent of the turnover is generated by about 10,000 parts from 860,000 parts.

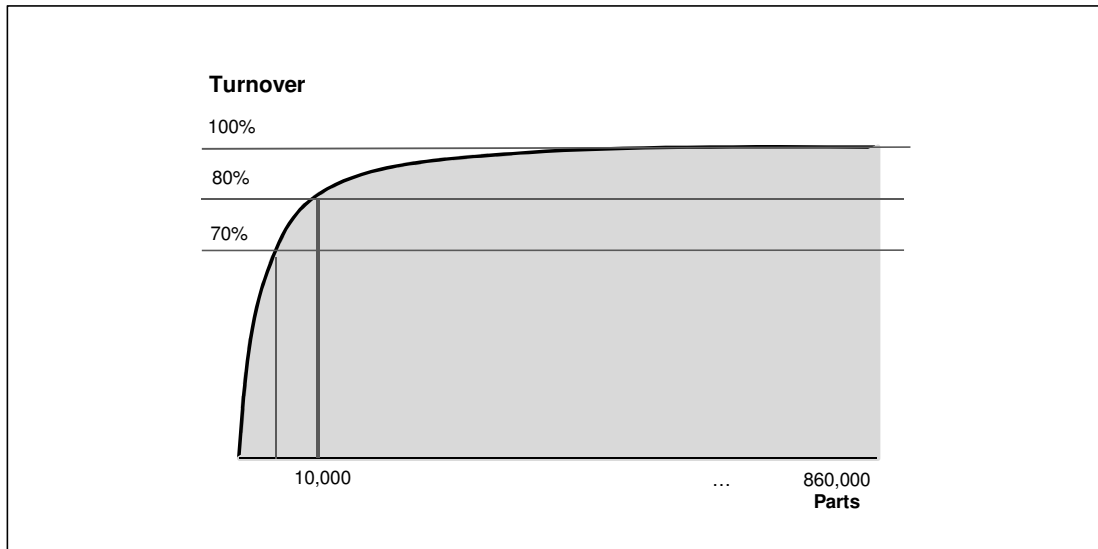


Figure 19: ABC Analysis: Example of an OEM: 80 per cent of Turnover is generated by 10,000 Parts

Also regarding the intensity of competition different parts groups can be distinguished. Parts are replaced for three basic reasons: after accidents or crashes, when they fail to work or are damaged, and because of wear and tear. Accidents and crashes mostly concern body parts such as bumpers, bonnets, side and front panels, doors, headlamps, etc. Radiators, scratched bumpers, air-conditioning, windscreen and lighting are the parts that require replacing because of failure or damage. And finally parts, such as tires, oil filters, brakes, batteries, shock absorbers, spark plugs as well as exhausts, which are often replaced because of wear. The wear-driven spare parts market is highly competitive. The accident-driven spare parts market is exerted to lesser competition, because it mostly comprises captive spare parts, supplied mainly by car manufacturers (Blanchet/Rade, 2007, p. 187 f).

In this segment vehicle manufacturers benefit partly from design protection and intellectual property rights protection that are valid both in OE and aftermarket segments (LE, 2006, p. 242). But in practice, in many markets, also in Austria like in Germany, trade with visible exterior body parts, which are delivered from independent aftermarket, is not restrained by OEMs. Nevertheless the market share of independents is still rather low (EurotaxGlass No. 2091, p. 3).

5.5.3 Spare Parts Supply Chain

The spare parts supply chain comprises a number of stages with, at one end, the parts producers and, at the other end, the final customers, which include both repairers and car owners. Between producers and end customers there exists a layer of wholesalers. These businesses fulfil an aggregating function, whereby a very large number of parts from many different suppliers are made available from a single distributor. The aggregating function in between layers is a crucial component of the parts supply chain, as it would be impractical for OESs to sell directly to repairers. Given the vast number of parts that a typical repairer requires, buying each type of part from different suppliers would be costly and a logistical nightmare.

Spare parts are distributed via two basic channels which are the vehicle manufacturer and the independent channel. The two channels, vehicle makers and independents are competing for aftermarket sales. Although OEMs supply a large portion of all the parts, they do not themselves produce more than about 20 to 30 per cent of that total. OEMs source most of the parts they distribute from OESs. Overall, they have gained a strong position at the wholesale distribution level, with a market share estimated at about 55 per cent. The other 45 per cent are distributed through independent wholesalers who purchase parts from both OES and firms that supply their products directly, in some cases exclusively, to the independent aftermarket. Carmakers have traditionally supplied most of the spare parts used by the dealer network, a majority of which are sourced from the OESs. For the distribution of spare parts, car manufacturers have invested heavily in sophisticated systems for parts procurement, warehousing, logistics, cataloguing and IT systems (Maxton/Wormald, 2004, p. 172).

An important structural feature of spare parts distribution is, as mentioned, its multi-level structure according to the respective sales levels. Parts are stored in central OEM warehouses, in local wholesale depots as well as at the authorized dealers and repairers. Basically this multi-level system opens up the possibility of bypass solutions both in horizontal and vertical direction (Diez, 2006, p. 360).

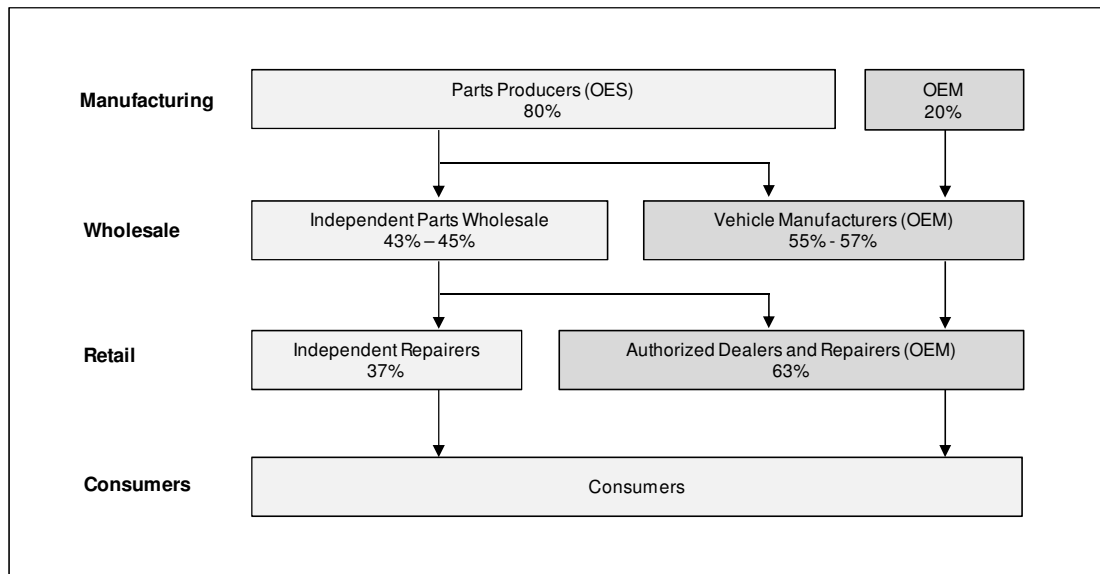


Figure 20: Spare Parts Supply Chain (FIGIEFA, www.figiefa.eu)

5.5.4 Competitive Environment in Spare Parts Distribution

Also in the spare parts business the intensity of competition between manufacturer channels and independent providers is increasing. Incumbents are experiencing difficulties in defending market share from competitors and new entrants (Oliver Wyman, 2009; McKinsey, 2008, p. 52).

Suppliers try to win market share and additional trade margins from OEMs by selling spare parts directly and under their own spare parts brand. Parts manufacturers seem to see independent repairer groups as a convenient way to bypass car manufacturers and deal with customers directly, a strategy which is also facilitated by the Block Exemption Regulation. Moreover under the new BER, car manufacturers cannot require their authorized dealers or repairers to buy their parts from the OEM's supply network. They have the freedom to source their parts directly from parts manufacturers or parts wholesalers, without having to go through the vehicle manufacturers' distribution channels (LE, 2006, p. 160, 250 f). As a consequence OEMs lose market shares and profits because repairers can now order directly from the OES or belong to parts distributor networks.

A number of OESs and parts distributors in Western Europe have also established their own aftersales service providers, mainly through the launch of franchised concepts. In Western Europe, a group characterized as "integrated OESs" manufactures parts, distributes them, and manages own-franchised or wholly owned service networks. For example, Bosch maintains perhaps one of the most integrated aftersales networks, including logistics (Centro) and franchised garages (1a autoservice,

Bosch Car Service). Traditional OESs, on the other hand, focus primarily on parts manufacturing, while independent distributors quite often engage in both parts distribution and service delivery. Through increasing size and bargaining power the parts wholesalers and producers, in their function as system providers, are able to realize economies of scale on parts logistics and warehousing, which offer to their system members enormous price political leeway. The associated workshops can take advantage of central marketing activities, mutual know-how transfer as well as IT-supported information exchange (McKinsey, 2008, p. 24).

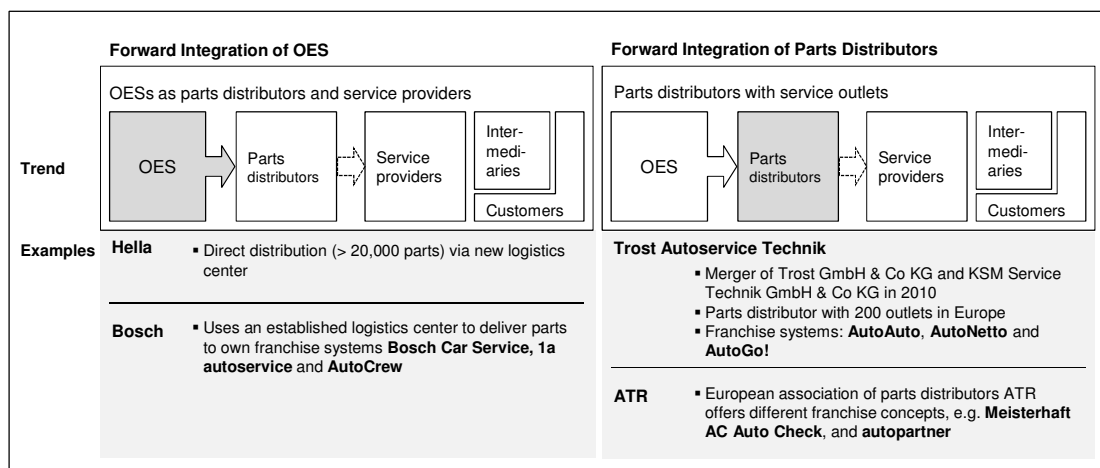


Figure 21: Examples of forward Integration of OESs and Parts Distributors (McKinsey, 2008, p. 23, www.trost.com)

Many parts distributors have grown over the years by acquiring smaller competitors and leading distributors have emerged. Some examples are Trost Autoservice SE, Stahlgruber, PV Autoteile, Wessels+Müller AG and Métraux/Derendinger (Wolk & Partner, 2010, p. 4). This process of consolidation is driven by the need to provide wider inventory breadth and better service in terms of response times to customers. Parts distributors' sophistication is increasing as they invest in advanced supply chain technology to provide integrated customer fulfilment and web-based ordering. As they get bigger, parts distributors are beginning to leverage their buying power and as a result are placing increased pressure on supplier margins, in order to compete with the OEM distribution channels. Parts distributors are turning to increasingly sophisticated technology that allows for greater efficiency and reduced response time as a means to compete with the authorized network (LE, 2006, p. 266).

There are also new entrants in the spare parts business which go mainly after profitable high-volume commodity product categories, such as filters, leading to a significant increase in price competition. Furthermore, independent distributors heat up the competition by expanding their portfolio and increasing sales promotions. The

IAM channel offers also more aggressive discounts and parts rebates. This leads to the situation that also in the aftersales business companies along the entire value chain are increasingly confronted with margin erosion across their product portfolio. Typical examples of this trend include tires as well as wear-and-tear parts, such as brakes, exhaust systems, batteries, and shock absorbers. On the other hand it has to be amended that, due to steadily increasing complexity of cars, there's a clear trend towards comprehensive and complex spare parts modules instead of single parts (e.g. headlamps). Of course, this development increases the market-entry barrier for new competitors in this segment (McKinsey, 2008, p. 52).

5.5.4.1 Overview Main Players in Spare Parts Business in Austria

Main Parts Distributors	
<p>Birner</p> <ul style="list-style-type: none"> ▪ Parts distributor with 23 outlets ▪ Turnover: € 117 million (2010) ▪ Product groups with high turnover: brakes, turbo-chargers ▪ Franchise systems: <ul style="list-style-type: none"> ▪ ad Autodienst: 110 outlets ▪ Automobil Meisterwerkstatt: 135 outlets ▪ Concept "Autofreund": <ul style="list-style-type: none"> ▪ Cooperation of independent local parts distributors under one logo ▪ Support of marketing activities ▪ Access to trainings ▪ Agreement of yearly minimum turnover with Birner ▪ Currently 55 members 	<p>Derendinger</p> <ul style="list-style-type: none"> ▪ Parts distributor with 27 outlets ▪ Turnover: € 60,8 million (2010) ▪ Core business spare parts and workshop equipment ▪ Main product groups: clutches, brakes, electronics, air conditioning ▪ Own trademark Power Plus: low price oil, lubricants and batteries ▪ Franchise system: <ul style="list-style-type: none"> ▪ plusService: 72 outlets
<p>Stahlgruber</p> <ul style="list-style-type: none"> ▪ Parts distributor with 12 outlets ▪ Turnover: € 89 million (2010) ▪ Franchise system: <ul style="list-style-type: none"> ▪ Meisterhaft: 139 outlets ▪ Concept developed by ATR 	<p>Trost Autoservice Technik</p> <ul style="list-style-type: none"> ▪ Parts distributor with 9 outlets ▪ Turnover: € 12 million (estimated) ▪ Franchise systems: <ul style="list-style-type: none"> ▪ AutoAuto: full concept ▪ AutoNetto: umbrella brand for low-price repairs ▪ AutoGo!: fast service in urban areas ▪ www.autoservice.com: <ul style="list-style-type: none"> ▪ Information- and presentation platform ▪ Currently 115 participating workshops
<p>ATP Auto Teile Partner</p> <ul style="list-style-type: none"> ▪ Buying cooperative of parts wholesalers and retailers ▪ Cooperation with German Coparts subsidiary Global Automotive Service GmbH for original spare parts ▪ 19 partners with 31 outlets ▪ Turnover € 80 million (2010) ▪ Franchise system: <ul style="list-style-type: none"> ▪ Profiservice: 45 outlets 	<p>Local Parts Suppliers</p> <ul style="list-style-type: none"> ▪ About 200 local parts suppliers

Service and Parts Providers	
<p>Forstinger</p> <ul style="list-style-type: none"> ▪ Spare parts and accessories, workshops ▪ Chain with 118 outlets ▪ Turnover: € 132 million (2010) ▪ Workshops offer fast-fitting services (brakes, exhaust, air-conditioning, oil, etc.) 	<p>ATU Auto Teile Unger</p> <ul style="list-style-type: none"> ▪ Workshop, parts, accessories ▪ Chain with 25 outlets ▪ Turnover: € 32 million (estimated) ▪ Approx. 1/3 of turnover with tires, antifreeze ▪ Fast service at low prices (25% below OEM)

OES and Service Outlets	
<p>Bosch Car Service</p> <ul style="list-style-type: none"> ▪ 110 outlets ▪ Focus on training program "Bosch Service Excellence": 13 modules supporting program ▪ Franchise system: <ul style="list-style-type: none"> ▪ 4 Workshop-Modules: 190 modul partners ▪ Autocrew: 16 outlets (planned 40 – 50 outlets) 	<p>Hella Austria GmbH</p> <ul style="list-style-type: none"> ▪ Franchise system: <ul style="list-style-type: none"> ▪ 15 Diesel specialized outlets ▪ Delphi Service Center: (started in 2011): 4 outlets (planned 50 partners within 3 years)

Figure 22: Overview Main Players in Spare Parts Business in Austria (Birner: Auto & Wirtschaft, 2010, p. 65, www.meisterwerkstatt.at, EurotaxGlass No. 2053, p. 7; No. 2072, p. 4; No. 2076, p. 3; No. 2077, p. 9; No. 2090, p. 15; No. 2092, p. 4, p. 11, p. 12; No. 2093, p. 15), EurotaxGlass No. 2090, p. 2, p. 1; www.forstinger.at, EurotaxGlass No. 2053, p. 13; No. 2096, p. 13; No. 2099, p. 10)

6 Relationship Marketing and Loyalty

6.1 Relationship Management Manufacturer – Dealer/Repairer

The distribution channel in automotive retail and service can be defined as a vertical marketing system. A vertical marketing system comprises the producer, wholesaler(s), and retailer(s) acting as a unified system. One channel member, the channel captain or system leader, owns the others or franchises them or has so much power that they all cooperate. Vertical marketing systems arose as a result of strong channel members' attempts to control channel behaviour and eliminate the conflict that results when independent channel members pursue their own objectives (Kotler/Keller, 2006, p. 246).

A basic structural feature of vertical marketing in the automotive industry is the system leadership of vehicle manufacturers towards automotive retail. The OEM's marketing leadership is supported by the coordination principles "contract" and "power". The contractual regulations and obligations are laid down in the dealer contract. But the potential of car manufacturers to execute system leadership out of the dealer contract has been decreasing. Thus the risk of erosion of the existing contractual distribution systems, if new players increasingly try to enter the existing dealer and service networks, is rising. The market has moved on and authorized dealers now have more sourcing alternatives. Independent parts dealers have consolidated and strengthened their logistics performance.

As a result of the diluted legal binding possibilities, manufacturers see gaining intermediaries' cooperation as a huge challenge, and strategies for stabilization and improvement of manufacturer-dealer relationships and dealer loyalty in the automotive industry become even more important (Diez, 2006, p. 332 f; Reindl, 2005, p. 44 f). According to a research of Reindl the power of manufacturers to exert influence is based on a set of partly economic and partly psychosocial factors. Particular important determinants of manufacturers' inter-organizational power proved to be "hard" factors such as offering higher value-added possibilities to retailers based on the brand value and image as well as the strong resources of the respective manufacturer (for example: high innovation power, quality and attractiveness of product range, etc.) (Reindl, 2005, p. 281 f). The optimization of manufacturer-dealer relationship is of fundamental importance for achieving distribution and sales targets (Diez, 2006, p. 347). The manufacturer's vertical marketing is aiming at gaining the

dealer's cooperation and strengthen their loyalty in order to achieve the marketing targets such as high sales, market exploitation and customer retention, as well as effective brand management at low distribution cost. Here, the trend to source parts from third parties has an immediate negative effect on the OEM's business. To meet their targets manufacturers apply monetary as well as non-monetary motivators. The most important non-monetary steering instruments to stimulate retail are marketing and advertising support, the centrally managed implementation of sales promotions, consulting and support by OEM field staff as well as trainings for dealers' employees (Diez, 2006, p. 336 f).

Manufacturers can also resort to monetary incentives such as concession of base discounts (trade margin), payment of bonuses, rebates and premiums, as well as in some cases advertising allowances and financial investment support to influence, among other things dealers' choice between OEM supplied parts and those supplied by the independent market (LE, 2006, p. 248). Due to their particular importance automotive margin systems as part of the pricing policy will be elaborated more in detail in the following sections.

6.2 Key Variables of Relationship Success

A crucial issue from a practical standpoint concerns the constructs determining customer retention or loyalty. Here, relationship marketing research has reached a relatively advanced state. While several different determining variables have been proposed, the discussion clearly focuses on the three constructs of customer satisfaction, trust, and commitment.

Customer satisfaction is understood as the customer's emotional or empathic reaction to a perceived difference between performance appraisal and expectations. Broadly speaking, disconfirmed expectations lead to dissatisfaction, while the confirmation of expectations lead to satisfaction (Oliver, 1980, p. 460 f).

Trust exists if a customer believes a service provider to be reliable and to have a high degree of integrity. As the development of trust in the provider is a powerful strategy for reducing the risk perceived by customers in a transaction, trust is of particular importance when a high degree of uncertainty exists (Grönroos, 1994, p. 4 f).

Commitment can be described as the customer's orientation towards a long-term business relationship, based on emotional bonds and a conviction that remaining in the relationship will yield higher net benefits than terminating it (Söllner, 1994).

6.3 Customer Satisfaction, Loyalty and their Economic Effects on Profit

A variety of studies find that higher levels of customer satisfaction lead to greater customer loyalty. Through increasing loyalty, it is argued, customer satisfaction helps to secure future revenues and growth by building long-term customer relations and reduce the costs of future transactions. Therefore loyal customers represent an important intangible asset which seems to be of great significance considering the high market saturation in many consumer and capital goods markets (Anderson et al, 1997, p. 131). Another argument for the positive effect on profitability is the decreasing price sensitivity of loyal customers. In particular Reichheld/Sasser (1990, p. 105 f) point to decreasing price sensitivity connected with high loyalty. They argue that satisfied customers are prepared to pay more for a product or service, they are less aware of substitutes and their willingness to change to a competitor with a cheaper offer decreases. This lower price sensitivity provides more price policy possibilities and makes it more difficult for competitors to respond. Often considerable price reductions and free additional services from competitors are not sufficient to entice satisfied customers away. As a consequence lower price sensitivity increases cash flow. On the one hand higher prices can be enforced more easily, on the other hand customers respond slowly to short-term price campaigns of competitors. The threat of ruinous price competitions is significantly lower with high customer satisfaction and loyalty (Reichheld/Sasser, 1991, p. 108 f).

With increasing duration of a business relation the mutual tolerance of the business partners is rising. The likelihood increases that the customer stays loyal to his supplier even if he once fails to meet an expected performance. The greater tolerance is connected especially with a higher level of interaction which results from a long-term relation between the partners. This intense cooperation is reflected in a higher willingness for reciprocal information exchange. Loyal customers are more prepared to complain, to answer questionnaires and perhaps even to work together with the supplier in building up customer satisfaction programs. Increased feedback and more frequent contact gives a supplier more scope in terms of marketing and helps the supplier to continuously control and improve his product or service quality (Hen-

nig-Thurau/Hansen, 2000, p. 32). In summary it can be said that loyalty really is an important goal of relationship marketing and a worthy asset for a company which contributes to the shareholder value of a company.

6.4 Success Chain of Relationship Marketing and Loyalty

To influence customer loyalty, ensuring a high customer satisfaction is necessary, which from customer's perspective results from the comparison of the services received with his expectations (Oliver, 1996; Homburg/Stock-Homburg, 2008, p. 17 f). This shows the connection between customer orientation and customer satisfaction. While customer orientation includes a comprehensive consideration of customer expectations, customer satisfaction relates to the degree of fulfilment of the customers' expectations (Bruhn, 2003, p. 66). A high level of customer orientation is therefore the prerequisite of a high level of customer satisfaction.

Several studies also prove a positive correlation between customer satisfaction and loyalty (Johes/Sasser, 1995, p. 88 f). Satisfied customers whose expectations are met or exceeded are more likely prepared to re-purchase and maintain a business relationship. A highly satisfied customer generally stays loyal longer and buys more as the company introduces new products and upgrades existing ones (Kotler et al, 2009, p. 390). Based on these considerations an effect chain is resulting with the relating links customer orientation, customer satisfaction and loyalty, which is called success chain of relationship marketing. This chain is determined by moderating external and internal factors, so that the realisation of customer orientation requires a comprehensive steering of these success factors (Bruhn, 2003, p. 54).

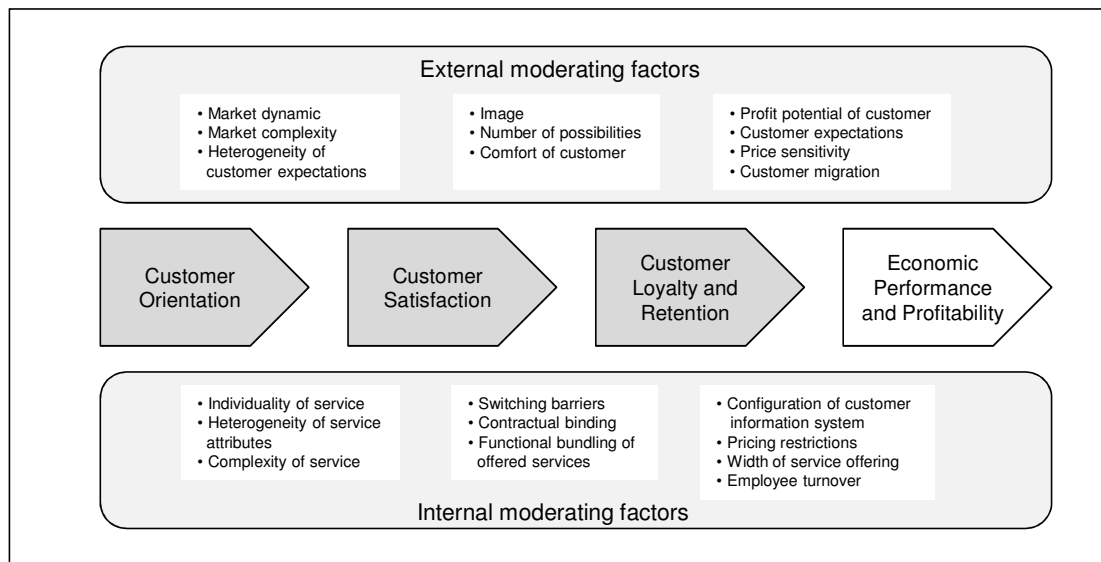


Figure 23: Success Chain of Relationship Marketing (Bruhn, 2008, p. 39)

A dealer can also be regarded as a „customer“ of a company because he demands a company’s products as well. However the supplier-dealer relationship is characterized by a mutual dependency which is subject to a higher intensity of interaction as a supplier-customer relationship (Decker, 2000). Moreover the dealer is bound to a legal framework which limits his scope of action in comparison to a private customer. A customer can switch to another supplier with less effort whereas the switching costs for a dealer to another manufacturer are much higher. But as already mentioned car manufacturer’s binding possibilities out of the contract have been decreasing due to changes in the regulatory framework regarding car sales and service.

According to the construct of customer satisfaction, dealer satisfaction can be defined as the result of a complex information processing process in a business relationship, which is based on a context-related evaluation, i.e. influenced by situational and structural factors, of actual experience of the manufacturer’s performance based on expected brand-specific standards by the dealers (Schwacke Marken-Monitor, 2006). In contradistinction to customer satisfaction, dealer satisfaction is a satisfaction “within” (and not simply “with”) a long-term oriented business relationship. This means that the dealer satisfaction is influenced not only by the direct manufacturer-dealer relationship, but also by situational factors, such as current earning and profit situation, which is one of the most important drivers of dealer satisfaction (Schwacke Marken-Monitor, 2011; Meunzel, 2011, p. 3). With their bonus and margin systems car manufacturers can take direct influence on their dealers’

profitability. Dealer satisfaction is a holistic construct and therefore a suitable indicator for measuring and managing a sales culture (Diez, 2006, p. 349 f).

6.5 Strategies of Customer Retention: Generate Repurchases

Basically companies can grow and achieve higher revenues and profits with new and/or existing customers (Kotler et al, 2009, p. 398). In stagnating markets with strong competition and high acquisition cost, growth and profit with existing customers become increasingly important. There are also markets where an existing customer base and customer loyalty is the basis for a future exchange process (e.g. supplier business, system business) (Backhaus, 1999, p. 298 f).

Looking at the relationship between supplier and customer, customer loyalty can be defined and measured in terms of the amount and the quality of interactions between both parties. Customers will declare themselves loyal to a supplier through feelings and perceptions of (high) satisfaction, through positive attitudes and through certain preferences for the supplier, meaning that customers will be willing to repurchase from this supplier (Hennig-Thurau/Hansen, 2000, p. 30). Oliver defines loyalty as “A deeply held commitment to re-buy or re-patronise a preferred product or service in the future despite situational influences and marketing efforts having the potential to cause switching behaviour” (Kotler et al, 2009, p. 386).

Regarding customer loyalty two strategies have to be pursued: Make sure that

1. customers *stay* with the company and *don't switch* to another supplier and/or
2. customers *increasingly buy* from the company.

The first strategy strives for a low migration rate, as well as a permanent presence at the customer between purchases and repurchase. The second strategy goes one step further. The bottom line is to increase revenue and contribution margin per customer. Sales can increase as customers buy larger quantities, i.e. by increasing intensity of purchase or when customers buy more often, i.e. increased purchase frequency. Moreover a higher price tolerance can be exploited, which affects net price and has therefore a positive impact on revenue and contribution margin (Tomczak et al, 2009, p. 111).

6.6 Types of Customer Loyalty and Switching Cost

Customer bonding may be seen as a process which influences customers, and customer loyalty as the result of this process. Suppliers will define customer bonding as a bundle of activities, which builds up intensive relationship with customers, including contact opportunities, barriers to a change of supplier or creation of customer preferences for the supplier (which may be based on technology, materials, staff, etc.) (Hennig-Thurau/Hansen, 2000, p. 30). Customer bonding exists when switching costs hamper or prevent, at least in the short term, the migration of customers to another supplier. According to Klemperer (1987, p. 375 f.) several types of switching costs can be distinguished: Direct switching costs or transaction cost, which will also arise when switching to an identical product of a competitor. The customer has to look for an alternative, has to evaluate the product and finally buy it. A process which is time consuming and can cause cost.

Learning cost can be incurred when the learning and knowledge required to use one product may not be transferrable to other brands of the same product even though all brands are functionally identical. For example trainings are necessary to handle the new programs or products. A third type of switching costs is artificial or contractual switching cost which arises entirely at firms' discretion to make it more difficult for the customer to switch. Examples are bonus and reward programs or bonus and discount systems in retail. Similar switching costs can be created by contracts which arise when withdrawing from a contract. Psychological switching costs can influence customers to stay with a supplier not because of economic or monetary considerations but as a consequence of habit, routine, satisfaction or trust.

If a change to another supplier takes place, depends first on the relationship and the existing bonding between supplier and customer, and second on the available switching options of the customer:

First: Within the relationship between supplier and customer two basic types of binding can be distinguished. On the one hand there are bindings leading to the situation that a customer "must" stay within a relationship, he is or feels dependent on. These "must-bindings" are caused primarily by the fact that due to specific investments a customer can switch the supplier only by experiencing a loss. On the other hand bindings can lead to the situation that a customer "wants" to stay in the relationship (Figure 24).

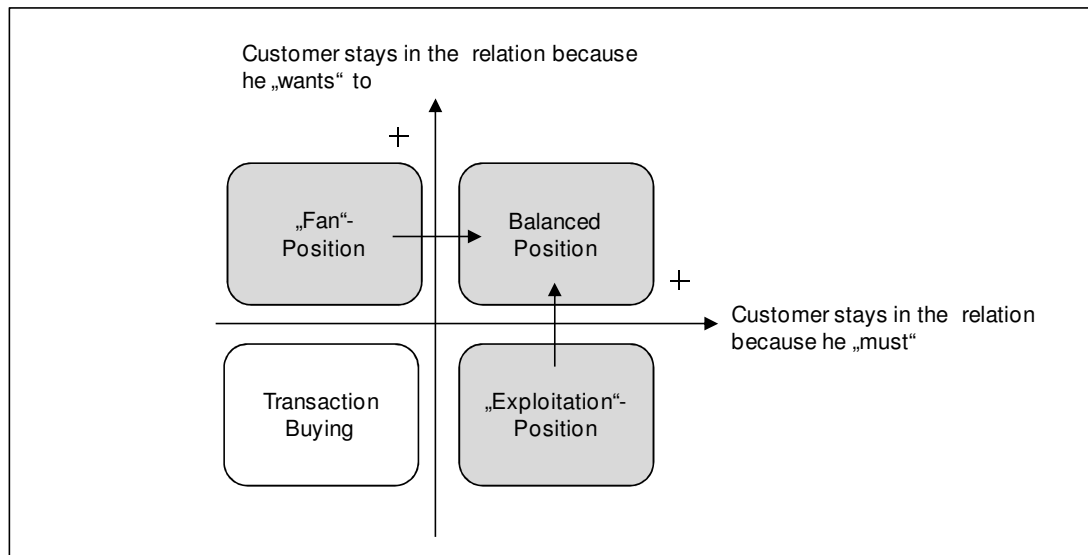


Figure 24: Customer Position according to Type of Binding (Tomczak et al, 2009, p. 114)

Based on this matrix, the position of each customer within a business relationship can be described. A customer who doesn't want nor must repurchase, won't enter into a business relationship (transaction buying). Customers are in a fan-position when they want to stay in a relationship but, for example due to dissatisfaction, can switch the supplier at any time. This position is very typical for the classical service and consumer goods business.

The balanced position includes "want" as well as "must" bindings. Examples are satisfied customers of parts through just in time delivery. Is a customer dissatisfied in a locked in situation, he is in an exploitation situation. This situation exists in monopoly markets as well as in the medium and short term in the business to business area, if specific investments of supplier and customer are not made at the same time or to the same extent. In the long run such a position bears risks as soon as the environment changes. Examples are the deregulation in the telecommunication and aviation industry or the entry of Japanese and European competitors in the US automobile market. Moreover regulatory changes, expiring contracts and patents or technology developments lead to new standards.

Therefore especially in competitive-intensive markets companies want to reach a balanced position for their customers by establishing a balanced mix of psychological as well as factual bindings. For the supplier it is important to identify types and strengths of customer bindings. Depending on the situation he must try to increase or, in the case of negatively perceived bindings, to reduce them or to offer appropriate alternative benefits. Loyal customers want to stay with the supplier, even though they don't have to, because in the ideal case they are very satisfied and trust the

supplier. Other phenomena that are subject of psychological bindings are confidence, habit or “internal commitment” towards the supplier.

The first three above mentioned types of switching costs create so-called factual bindings. These are over all material cost (in the broadest sense rewards/sanctions) of economic, technological as well as contractual nature. Customer binding takes into account both aspects.

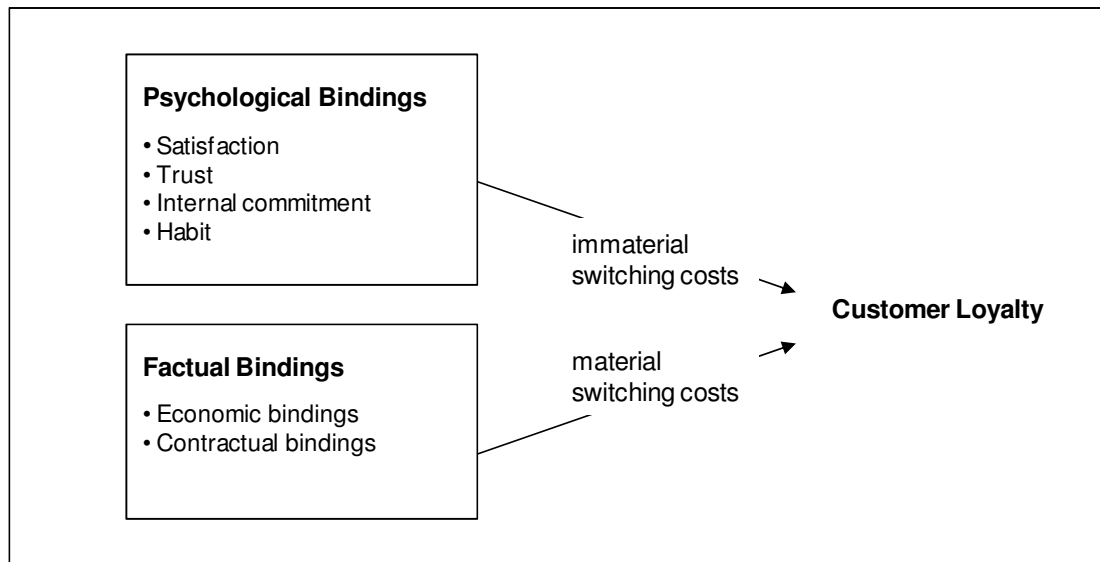


Figure 25: Psychological and Factual Bindings (Tomczak et al, 2009, p. 115)

Second: Companies don't act in isolation in the market. Customers evaluate vendors and services in relation to the existing alternatives. A change requires at least one more option; this means that there is no monopoly. In addition, the customer must know the alternative offers and must be able to judge them. Moreover his assessment should finally lead to a decision for one alternative. In extreme cases a customer will stay with his current supplier in spite of dissatisfaction and lack of other barriers, because all offers of the competitors create an even lower benefit. The concerning company is a quasi-monopoly (Tomczak et al, 2009, p. 113 f).

6.7 Motivators and Demotivators of Loyalty

6.7.1 Opportunism vs. Relief

The first, and perhaps strongest, factor constraining loyalty is opportunism, which in this context means the willingness of customers to take any opportunity to get more value for money and to be fully flexible. Customers try to optimize shopping by looking for the best ratio between price and performance and adopt flexible shopping

strategies (Diller, 2000, p. 40). This type of consumer is often called the "smart shopper" (Schmalen, 1996, p. 50 f).

Opportunism is thereby weakened by the need for relief. Psychologists like Berlyne (1960) see in this kind of motivation the need for more freedom from economic pressures and tasks, and an awareness of alternative human values, such as humanity, solidarity or personal loyalty - also in business relationships. Relationship marketing can make use of this particular motivational ambivalence and offer incentives which weaken opportunism or strengthen factors which address the need for relief. Guarantees of quality, performance or price competitiveness are one way of weakening opportunism (Spremann, 1988, p. 613 f).

6.7.2 Variety vs. Continuity

The second pair of ambivalent forces within the loyalty motivation system is variety seeking and continuity seeking. A desire for variety has its roots in a general motivation for stimulation and absence of boredom. At the same time, man is a creature of habit who loves the well-known and familiar. Which need is stronger depends on the respective product category and the marketing policies of the suppliers. Relationship marketers have to create incentives which strengthen the need for continuity and weaken the need for (supplier) variety. In many markets, product variation and differentiation offers variety and prevents customers from changing brands. Within some branches, cooperation with suppliers offering complementary goods can make a product or service on offer more varied and stimulating. Temporary discounts and other price stimuli (e.g. through bonus programs) may be a way of offering variety, but require care in their use due to the harmful long-term effects (Diller, 2000, p. 42).

6.7.3 Autonomy vs. Social Integration

The third pair of ambivalent forces pits autonomy against social integration. Autonomy means freedom from others and decision-making independence. To be successful, relationship marketing has to recognize this ambivalence and try to support the desire for autonomy and/or emphasize social integration when a customer is bound to a supplier (Diller, 2000, p. 42). The possibilities begin with the complete range of approaches to the individualization of (particularly) services, but also of products and communication activities. If the customer is offered a genuinely individual and unique package, then this satisfies his or her desire for autonomy, but is still a means of increasing loyalty (Berry/Gresham, 1986, p. 43 f).

Autonomy-conscious customers value the opportunity to become involved in critical dialogues. Examples include customer forums, hotlines and other channels for complaints, mediators for resolving disputes or formal arbitration procedures (Hansen 1995). It is also possible to emphasize the social integration aspects of customer loyalty. Loyal customers can be brought together in customer clubs, where they are able to satisfy their needs for affiliation. Group events, such as trips, are very important instruments in this respect. Loyalty can also be generated through symbols showing membership and are a good opportunity for emphasizing the customers' link to a company (Diller, 2000, p. 43).

6.8 Marketing Instruments for Managing Customer Relationship and Loyalty

Marketing provides a number of instruments to achieve an increase in customer loyalty. General instruments of customer loyalty are the four classical marketing instruments (4Ps: product, price, place, promotion) which offer the framework when identifying and developing adequate measures to enhance and maintain relationships with customers.

6.8.1 Product Policy

A key impact of relationship marketing on product policy is the integration of customized elements and value added services, which allow the supplier to differentiate its products and services from competitors' products and which build in particular technical-functional switching barriers. They contribute that customers attribute a much higher benefit to a business relationship (Beutin, 2008, p. 347 f).

In this context, the car manufacturers have the possibility to offer services to the contract dealers which provide an additional benefit. Here in particular OEMs can resort to logistic services. OEM's for example provide shipments for the complete catalogue of parts on a regular basis, or even go as far as to manage their repairers' inventory. For the OEMs such vendor managed inventory projects help to maintain their market share and offload their repairers with the burden of managing their stock.

Another possibility is the offer of a same-day delivery to contract dealers with spare parts or to organize disposal or to take over the disposal costs for used parts. The

provision of marketing tools for sales support to end customers is a further service of manufacturers towards their dealers.

6.8.2 Communication Policy

Communication policy is centred on the continuous interactive communication with the customer to keep and increase his trust in the company and its products and services (Bruhn, 2002). But also the reminding of the company's services as well as communication of new services, the coordination of programs to increase commitment and loyalty are tasks of communication policy. Communication between the partners is important in terms of what is communicated and how it is communicated. Communication can be overt or the manifestation of more subtle, yet fundamental partnership attributes such as trust and commitment (Anderson/Lodish/Weitz, 1987, p. 87).

Part of the communication policy is for example the installation of a complaint management. While satisfaction management's main purpose is to avoid the emergence of dissatisfaction, complaint management aims at the stabilization of relations at risk (Stauss/Seidel, 1998). A complaint management system is considered one of the most powerful tools for listening to customers. Complaint management where the supplier makes a clear effort to do something for the customer may help support loyalty (Hennig-Thurau/Hansen, 2000, p. 42). Customer satisfaction engendered through the appropriate treatment of complaints is known to lead to an increase in retention and positive word of mouth (Brown/Beltrani, 1989, 9 f). Attention should also be paid to customers where there is a risk that they switch to another customer but still have not complained yet (early warning systems).

The systematic recording of dissatisfaction shows the contract dealers that the OEM is interested in an open approach to hear their opinion and the efforts for a continuous improvement of the business relationship. Automobile manufacturers should therefore see the contract dealers' complaints as a chance to react with flexibility on the short term but also to improve their processes. Another important means of communication and link between OEM and dealers is the support of contract dealers by field staff. Their range of tasks is manifold and includes mainly communicative and mediating functions. Therefore, the field staff is responsible to inform the dealership about current developments, such as promotions or trade marketing. On the other hand the field staff assumes a central function in the annual talks about sales targets and business plans. Also the organisation of dealer events such as regular

dealer conferences is part of communication measures. Such events are characterized by a high intensity of interaction and active customer integration (Zanger/Sistenich, 1996, p. 235).

6.8.3 Pricing Policy

Measures of pricing policy cause mainly economic customer loyalty. Pricing policy aims also at the application of price differentiation strategies due to the willingness of loyal customer to pay a price premium. Customer specific discounts or special conditions can also contribute to a resumption of business relationship, since they can influence the perceived value and benefits of a company's product or service. Moreover there is the possibility to create price incentives by one-time payments or refunding fees (Michalski, 2002).

With the determination of the dealer purchase price the automobile manufacturer takes direct influence on the financial attractiveness of the spare parts. Moreover bonuses and discounts actively steer the customer loyalty, by rewarding subsequent purchases of clients under consideration of time and economic criteria, in particular the price. Emphasis is put on an integrated concept and not on isolated special offers for regular customers. The aim is to develop a system of rewards that motivates customers and that effect continuous purchases (O'Brien/Jones, 1995, p. 98 f). For example at the retail level sales bonus payments can be granted for the achievement of certain turnover targets. Bonus systems are more worthwhile when they neutralize a competitor's program, broaden the availability of a product/service (by bonuses to dealers) or directly enhance the product/service value proposition (Dowling/Uncles 1997, p. 81).

6.8.4 Distribution Policy

By means of distribution policy technical-functional as well as contractual customer loyalty can be achieved. This binding can also be build by the installation of a specific channel (e.g. IT-software for a simplified purchase of goods, etc.). Here of cause the regulations in the dealer contract play an important role. Moreover modern IT-solutions help companies to perform customer segmentation, to map customer processes and to coordinate customer-oriented measures (Rese, 2002, p. 19 f). Another way to increase loyalty rates is to make ordering routine or automated, for example through electronic data interchange (EDI) or e-commerce. Ease of pur-

chase is a very important factor for customer purchasing (or repurchasing) a product or service.

6.8.5 Customer Satisfaction Management

Customer satisfaction is of overriding importance in the customer retention and loyalty marketing-mix. The relationship between customer satisfaction and their determinants (engagement, friendliness and competence of employees as well as satisfaction with the sales process) are empirically well proved. As already mentioned several studies show that there is a positive correlation between customer satisfaction and loyalty (Jones/Sasser, 1995, p. 88 f).

Figure 26 shows an example regarding the correlation between dealer satisfaction and dealer purchase loyalty. A McKinsey survey among 300 repair shop principals showed that many OEM authorized repair shops are dissatisfied with OEM support and seek to increase their share of non-OEM-sourced parts. While the best-in-class OEM has 72 per cent satisfied dealers and delivers 97 per cent of all spare parts ordered by its dealers, another OEM has a dealer satisfaction rate of just 38 per cent and receives only 72 per cent of the spare parts ordering volume of its franchised dealers (McKinsey, 2008, p. 52).

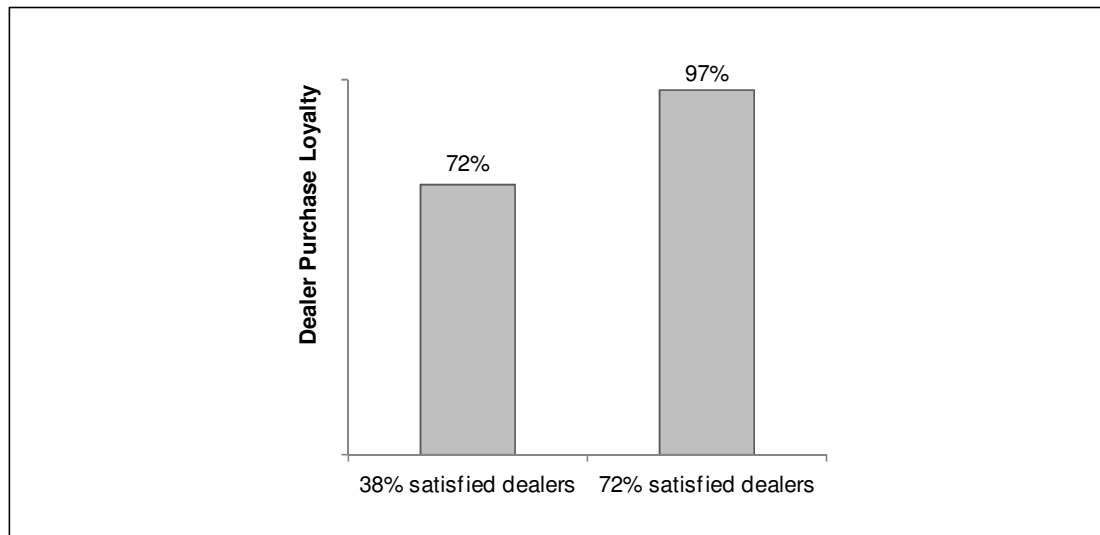


Figure 26: Correlation between Dealer Satisfaction and Dealer Purchase Loyalty (McKinsey, 2008, p. 52)

As already shown the service and repair business is the profit engine of the automotive industry. For a large number of car dealers this business is necessary to compensate the poor profitability in the car trade. Since the spare parts business makes also a large contribution to the profitability of vehicle manufacturers it is very impor-

tant to support dealer satisfaction. As mentioned, profitability is one of the most important drivers of dealer satisfaction, therefore it is important for OEMs by an intelligent overall pricing and margin structure in combination with the other marketing mix instruments, for example communication, to increase customer satisfaction in order to strengthen the still high dealer purchase loyalty.

7 Pricing Policy and Conditions of Sale

A key determinant of economic satisfaction in vertical business relationships is the price and conditions policy of suppliers (Geyskens, 1998, p. 118 f). Therefore the price policy and conditions of sale are main elements for the management of channel members and serve a manufacturer as a competition-, communication- and steering instrument. Moreover they determine the trade margin, which the dealer receives for his performance. In comparison to other marketing measures, pricing instruments can be changed on short-term notice and show relatively quickly an effect (Meffert et al, 2008, p. 478).

The price policy relates to the establishment of a price list and price differentiation instruments such as schedule of discounts and allowances that intermediaries see as equitable and sufficient. Conditions of sale refer to payment terms and guarantees (Kotler et al, 2009, p, 636 f). Conditions of sale and price policy can be based on purchase volume, time of purchase, payment conditions, logistic parameters, customer performance (e.g. sales increase, product presentation) or other indicators which are considered to be worth for price reduction (Steffenhagen, 2003, p. 583 f). With payment terms sellers stretch loans over longer periods and thus lower the monthly payment. With the instrument of vendor financing, manufacturers particularly want to increase sales by granting low-interest financing. The discount policy of the manufacturer is one of the most important influencing factors on manufacturer-dealer relationship, which in practice is reflected in the variety of different terms and conditions and the inventiveness regarding new types of discounts.

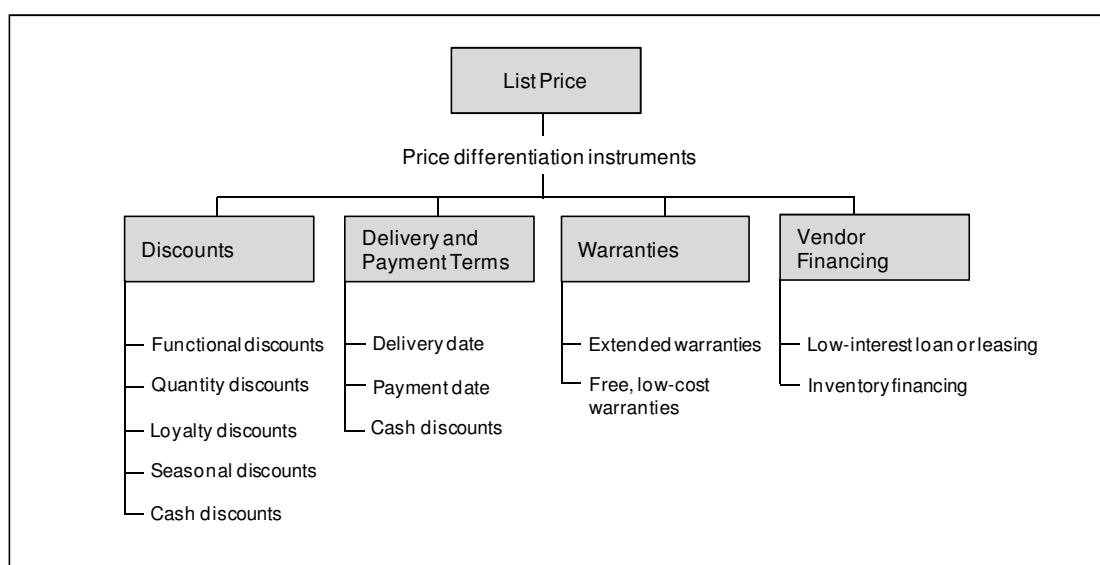


Figure 27: Instruments of Price Policy and Conditions of Sale (adapted from Simon/Fassnacht, 2009, p. 381)

Relationship-oriented pricing is centred on the application of price differentiation strategies (Hennig-Thurau/Hansen, 2000, p. 9). Therefore after the decision for a specific list price, discounts, bonus payments, sales financing as well as delivery and payment conditions must be determined, which in combination form a discount and margin system (Meffert et al, 2008, p. 544).

The performance of the dealer is rewarded with the trade margin, which is defined as the difference between the sales price and the purchase price of the trading goods (Schenk, 1991, p. 172 f). The trade margin can be expressed as an absolute amount or as a percentage. If it refers to the sales price it is called margin, if it refers to the purchase price it is called mark-up.

7.1 The List Price as Basis for Pricing Policy and Conditions

The list price represents the fixed standard remuneration, based on the manufacturer's and retailer's performance, for the purchase of a defined type and defined quantity of a product from the manufacturer. Therefore in the list price the manufacturer's performance as well as a defined typical standard retailer performance has to be considered (Steffenhagen, 1995, p. 69). Prices have a powerful influence on profitability and are the basis for the system of terms and conditions. The price depends on a number of different factors, including subjective price perception by customers, customers' subjective willingness to pay, price sensitivity, price modelling and the way prices are communicated.

Spare parts pricing is a complex mechanism, and can feature a hundred thousand different prices or more. The pricing of spare parts is influenced by various criteria, which include for example vehicle range. Even if a part is exactly the same across models, which is often the case due platform strategies followed by many OEMs, prices of parts are not identical and can show substantial differences, for instance between a Volkswagen and an Audi. The country's competitive environment is also a criterion. Here several factors need to be taken into consideration, such as the presence of low costs and the weight of IAM wholesalers. Whether or not parts are captive is another consideration. Renault, for example, modified its prices by pushing through higher rebates on competitive parts and lower rebates on body parts. As a result, the price of spare parts can become fairly disconnected from industrial costs (Blanchet/Rade, 2007 p. 203).

Spare parts prices differ significantly across different distribution channels. OEM authorized dealers are still able to sell spare parts at a price premium, at least in certain segments. But also dealers' purchase prices are in some segments higher than in the independent wholesale channel. This price positioning creates an overall negative price image of OEMs with negative impact on customer/dealer satisfaction. Since price is an important purchase decision, opportunism of dealers to get more value for money can put dealer loyalty at risk. Since contract dealers must be allowed to purchase outside the vehicle manufacturer channels it is a major challenge to avoid losing dealer purchase loyalty because of (perceived) high prices. However car manufacturers can successfully counteract a possible erosion of spare parts business by an active parts business strategy. Moreover manufacturers are able to resort to bonus payments, rebates and other incentives to influence dealer's choice between OEM-supplied parts and those supplied by the independent aftermarket (LE, 2006, p. 248).

7.2 Conditions of Sale as Pricing Instruments

The granting of discounts reduces the price which a customer finally has to pay for a product. Discounts can be given to end-consumers as well as to resellers, and are calculated as a percentage or as an absolute amount from the list price or the retailer purchase price. In business relationships discounts are granted for special retail performance which goes beyond the standard performance. Discounts to dealers can be granted in the form of functional-, volume-, time-, cash- or loyalty rebates (Meffert et al, 2008, p. 545 f).

7.2.1 Functional Discount

Functional discounts are granted for the execution of certain services, such as stock keeping or product presentation. Functional discounts apply to both, standard as well as supplementary tasks provided by the dealers. The discount level of functional discounts is determined by branch specific conditions or by commercial practice.

7.2.2 Quantity Discount

The provision of a quantity discount is based on the purchase of a certain volume. The retailer obtains a discount for purchasing a larger quantity of the product from the manufacturer (Simon/Fassnacht, 2009, p. 270). Because of higher order quanti-

ties the manufacturer can realize cost savings in production, sales and order processing, while the buyer takes the responsibility for stock keeping and price risk.

When designing a quantity discount scheme, a fixed discount as well as a proportional discount, which increases with increasing sales volume, can be applied. Particularly stimulating are progressive structured scaled discounts, which reward purchases of higher amounts disproportionately high. A quantity discount can refer to one single order or to a turnover made within a defined period. This type of ex-post quantity discount is also known as bonus (Krämer/Bongaerts/Weber, 2003, p. 556). As deferred compensation, which is paid usually after the end of the financial year, the amount of bonus depends on the value, the range and composition of the concluded delivery. Moreover it can be also based on loyalty rates. Therefore a bonus can be interpreted as a combination of quantity and loyalty discount, which are used by manufacturers for stabilizing their relationships with customers and/or dealers.

7.2.3 Loyalty Discount

Closely related to bonus payments are loyalty discounts, which offer an incentive to customers to buy goods exclusively, or at least mostly, from one supplier, and aim at increasing dealer loyalty to one supplier. From this loyalty results a certain sales volume between supplier and purchaser. Despite some similarities a loyalty discount differs from a bonus in the point, that its payment is not directly linked with sales volume. While a small customer can benefit from a loyalty discount also with lower volumes, this must not be the case for a larger customer who orders occasionally but realizes a higher sales volume. As a result loyalty discounts aim at long-term continuing orders and at strengthening the business relation between manufacturer and dealer (Meffert et al, 2008, p. 546).

7.2.4 Time-related Discount

Time-related discounts depend on the time of the order and refer to performance of the customer at the time of the order or purchase of a product. Such a discount is often granted as forward buying, product introduction, seasonal or phasing-out discount. Forward buying discounts apply when customers buy a greater quantity during a specified deal period than they can immediately sell. Seasonal discounts apply when products are ordered at the end or after a season. These discount types support the disposition or stock clearance of the manufacturer. Introduction or sales promotion discounts aim at creating a certain supply pressure at dealers during in-

roduction phase of a new product or during the action period. They shall stimulate the dealerships for special sales efforts. Phasing-out discounts aim at the clearance of old products from the manufacturer's stock (Meffert et al, 2008, p. 546).

7.2.5 Cash Discount

A cash discount is a price reduction given to customers for immediate payment of the invoice amount (Steffenhagen, 2003, p. 584). The granting of such a discount is based on financial considerations. It can be regarded as a compensation payment for not making use of longer payment terms or vendor financing. Thus from the customer's point of view it represents the saved interest (Meffert et al, 2008, p. 545).

7.2.6 Warranties

A warranty is a contractual agreement between the manufacturers and the buyer that requires the manufacturer either rectify item failures or compensate the buyer for failures that occur within the warranty period subsequent to its sale (Murthy/Blischke, 2006, p. 1). Companies can promote sales by adding a free or low-cost guarantee or warranty. To support customer retention manufacturers can offer also extended warranties to their customers which go beyond the legal obligations.

7.3 Margin and Discount Systems

In practice the outlined discount types and conditions are used in a combined form as a discount- or margin system. A margin system is a combination of remuneration elements which the dealer receives as margin for his performance in vertical marketing (Schenk, 1996, p. 43). The impact of a remuneration system is greatly affected by its design (Lawler, 1992, p. 3). The conditions must be carefully defined and linked to a coherent system. However, a discount system shouldn't be designed too extensively and complex, although the irreversibility of discounts, competitive considerations and the effort for a differentiated performance remuneration tend to enhance the number of various discounts. The price and condition system of a manufacturer should be performance-oriented and clearly structured. The performance can be defined as an activity or a business result of the supplier or customer; additional performance of a customer (supplier) leads to appropriate price adjustments by discounts of the list price, which is the price for standard performance in an industry. When there is a mutual understanding and interpretation of performance, the margin system will improve the fairness perception of the customers. The transition

to a new system can be problematic, as dealers see their received discounts at risk, which for them appear to be essential for being competitive (Diller, 2008, p. 226 f).

The price and discount policy can, amongst other things, aim at following goals (Meffert, 1986, p. 347):

- Increase of sales volume and revenue
- Improvement of customer/dealer loyalty
- Rationalization of the order processing process
- Steering of incoming orders according time
- Securing the image of premium priced goods and nevertheless making reasonable offers.

Basically it can be noted, that aim of the price and condition policy in manufacturer-dealer relationship is to take influence on the behaviour of the dealer by using financial incentives in order that the manufacturer achieves an improvement of the financial result, arising from a cost reduction and/or turnover increase. This exerting of influence can aim at the purchase behaviour as well as at the sales behaviour (Spork, 2006, p. 44).

8 Automotive Margin and Bonus Systems

Vehicle manufacturers are looking to maintain dealer loyalty by leveraging their logistics system for parts through the speed and frequency of delivery, high service level, technical support, and ultimately, by their pricing policy. The size and structure of the dealer margin is one of the most important elements in the dealer-manufacturer relationship because it determines the economic satisfaction of the dealers and therefore helps to build strong ties within the manufacturer's own channel. The margin and bonus system represents beside the other marketing instruments and qualitative standards the central instrument for the manufacturer to take influence on the behaviour of the contracted dealers.

The term margin and bonus system comprises all components of remuneration, which the dealer gets for his logistic and sales performance in the course of the sales process (Dudenhöfer, 2000, p. 45). As already mentioned before, in the sales process the dealer has to fulfil several tasks, such as customer relation management, product presentation, sales talks as well as product delivery and providing post-sale technical support and services. However, the dealer is not free in carrying out these tasks, but he must adhere to the standards laid down in the dealer contract. For his performance the dealer is remunerated with the dealer margin.

The automotive margin and bonus systems have experienced a fundamental development in recent years. On the basis of a simple system, which granted a constant margin, it came in the course of time and with the introduction of qualitative standards, to an enrichment of the dealer margin with various bonus components. The main disadvantage of traditional margin systems is the lack of performance differentiation. With the differentiation by bonus elements, manufacturers want to emphasize the performance character of the remuneration. So, for example, for most OEMs customer satisfaction has become a major objective which should be achieved with a performance-oriented margin and bonus system. On the other hand the increasing number of bonus elements has led to a greater complexity for dealers and also for manufacturers. But the trend towards increasingly complex margin systems in automobile sales seems broken.

Numerous car manufacturers and importers have started to simplify their margin and bonus systems in the last years in order to improve the handling for their dealers. According to IFA director Willi Diez, the manufacturers recognized that increasingly complex margin systems rather impede than encourage the steering of their dealer

networks: “What dealers need, are clear and calculable margins in car business”. In the last years it came to a substantial increase of premiums and incentives, which are used for short-term sales stimulation (IFA, 2008).

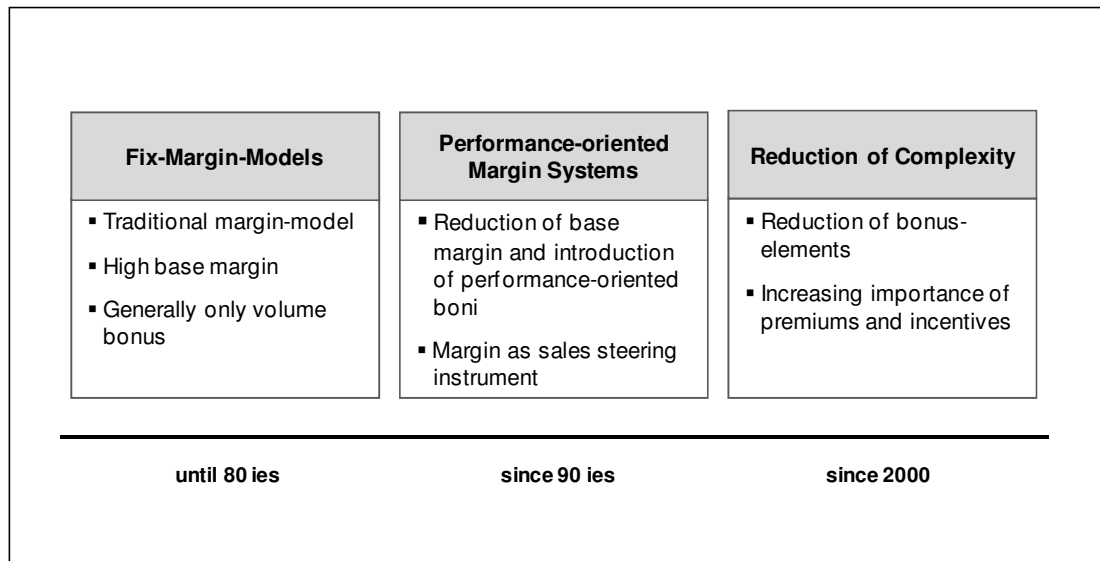


Figure 28: Development of Automotive Margin Systems (Diez, 2010, p. 94, source: IFA)

8.1 Components of the Dealer Trade Margin

Basically the trade margin is defined as the difference between sales price and purchase price. Its level is very important for the profitability of the dealer, and it should ensure the coverage of dealer’s sales costs and provide an adequate return on investment (Brachat, 2002, p. 78). In car retail the trade margin, calculated as difference between list sales price and retailer purchase price, is often theoretical for dealers as customer rebates have to be considered, which are for a volume brand typically about 7 per cent of the list sales price. (LE, 2006, p. 80).

In automotive trade usually a relative trade margin is applied, which is expressed as a percentage of the list price. This means, that a dealer receives for example 20 per cent of the manufacturer’s suggested list sales price for the sale of a vehicle or spare part. Manufacturers can grant different components of the dealer margin not only in relation to the list price but also in relation to the dealer purchase price. Consequence of the relative margin is that the absolute margin amount which can be achieved by the dealer increases with higher car prices/parts prices, whereas it decreases with lower prices (Diez/Calles/Merten, 2004, p. 19).

Margins given by car manufacturers to their affiliated dealers are divided into three main categories, which are the base margin, the bonus payments and premiums.

The total margin corresponds to the sum of these three categories and represents the maximum margin, which can be achieved, if all quantitative and qualitative criteria are met.

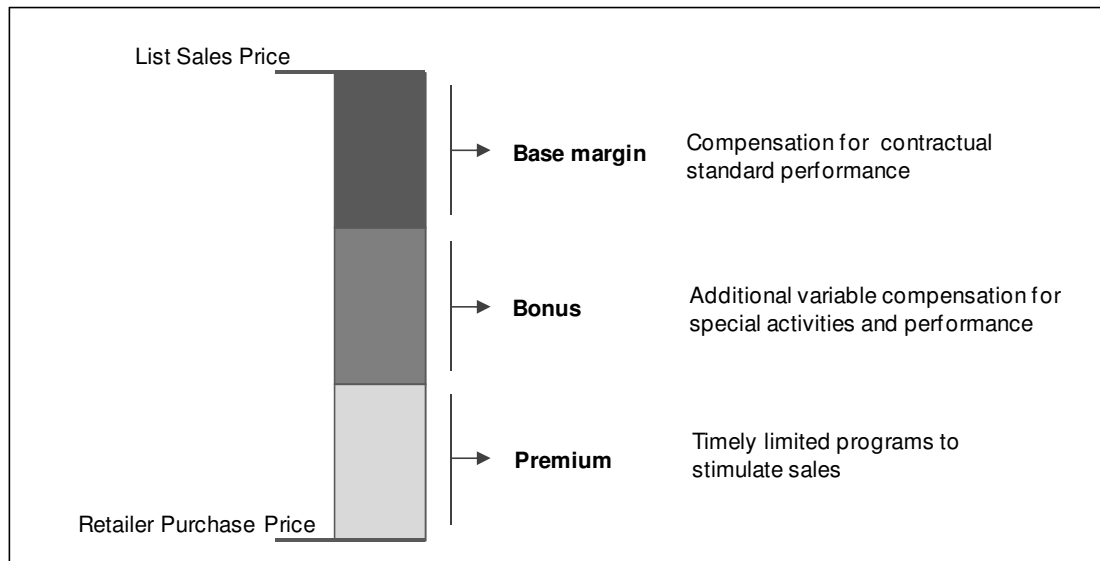


Figure 29: Structure of Margin- and Bonus-Systems

8.1.1 Base Margin

The base margin is the contract dealer's remuneration for the standard performance of his contractual duties and tasks, and is the implicit purpose of the dealer contract (Diez, 2006, p. 338). It is expressed as a fixed price discount offered from the manufacturer for his products and is granted to the dealer as a difference between the recommended list price and the retailer purchase price. The size of the base margin is depending on the model, i.e. different margins are paid for certain models or model groups. This approach should take into account that the marketing of premium vehicles requires higher sales efforts and customer support and thus causes higher sales costs for dealers.

In the spare parts business car manufacturers primarily differentiate the base margin of their authorized workshops according to the competitive situation in the different product groups. Rebates given to dealers in the captive parts segment are of the order of 12 per cent to 30 per cent, while those offered in competed parts segments are in the range of 30 per cent to 55 per cent (LE, 2006, p. 248).

8.1.2 Bonus Payments

A bonus is an additional variable margin granted by manufacturers for special activities of the contracted dealer (Diez, 2006, p. 338). The bonus payment consists of

several components which are linked to the achievement of a specific performance and target achievement. Thus a dealer can supplement the base margin with the achievement of the defined additional performance. In this context lies the immanent behavioural steering function of variable incentives. The level of target achievement determines the different bonus levels so that the final bonus can only be calculated after provision and control of the performance. In the course of the last adjustments of the dealer remuneration systems it came to a steady “variabilization” and shift from base margin to bonus components which are bound to specific criteria (Diez/Calles/Merten, 2004). However this increased use of bonus payments is only effective if the underlying performance criteria can be influenced by the dealers. Otherwise the bonus cannot develop its full motivation power.

The bonus payments are usually made by the end of the year, whereas also, for example quarterly pre-payments can be carried out on the basis of a preliminary classification. However, the dealer knows only with a certain time delay, if he has successfully closed the financial year (Diez, 2006, p. 340). Depending on the car manufacturer, authorized dealers can increase their margins by up to seven percentage points with bonus payments (Reers, 2007, p. 159).

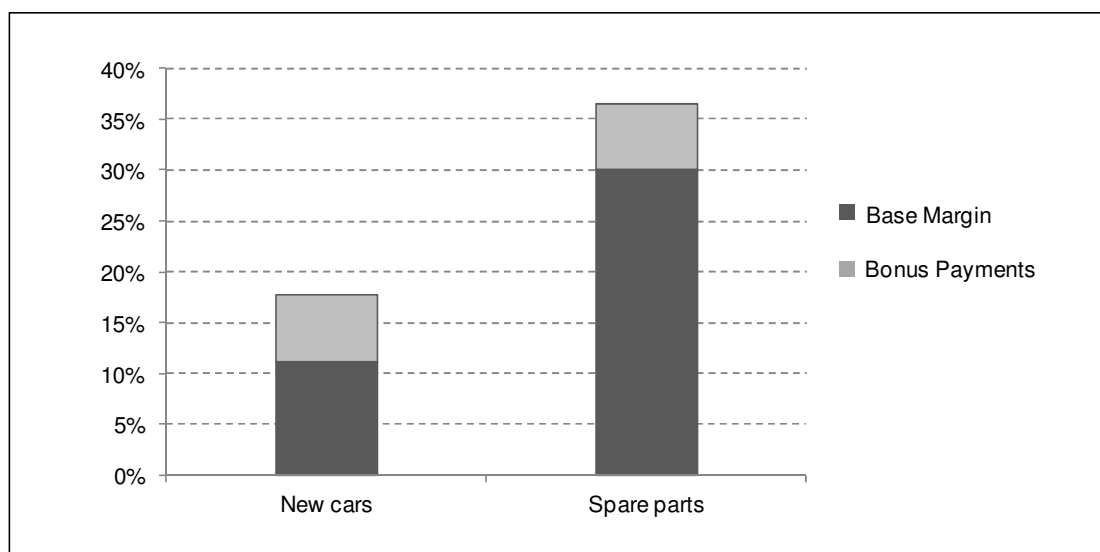


Figure 30: Average Margin Structure in New Car and Spare Parts Business (LE, 2006, p. 81; Diez, 2010, p. 96)

8.1.3 Premiums and Incentives

A premium represents a financial support of the contract dealer by the manufacturer, which is granted for a limited period in special market situations. A premium is not part of the contractual compensation. Usually they are granted for short-term sales

stimulation, for example in the form of registration premiums, to improve sales of lower-performing models (Diez, 2006, p. 338). Although premiums are voluntary benefits of the manufacturer and are not part of the dealer contract, they are regarded as part of the margin- and bonus system.

Most of the contract dealers see incentive programs as necessary, since the normal dealer margin is too low. It is interesting to note, that dealers assess special financing- and leasing programs better than registration premiums. Also trade-in premiums for used cars are rated favourably by dealers (IFA, 2008). These voluntary premium payments represent a considerable source of income. If you add dealer's base margin, bonus payments and voluntary premiums for sales incentive programs, then the premiums account on average for 13.8 per cent of the total margin (Meunzel, 2010, p. 18).

8.2 Requirements on Automotive Margin and Bonus Systems

Derived from the common target system of automobile distribution (market exploitation and customer retention) the following requirements can be made on a margin system (Diez, 2006, p. 337 f).

Increase of market exploitation: The margin system should be an incentive for active market exploitation by dealers. They should be motivated to capture market potential and to increase the market share in their market territory. Manufacturers have the goal to achieve optimal market exploitation by keeping the sales costs as low as possible.

Increase of customer satisfaction: Beside the short term market exploitation a margin system shall provide an incentive for customer relation management. High customer satisfaction contributes to safeguard the long-term revenues and profits. It is proven, that there is a correlation between customer satisfaction and the dealer/manufacturer loyalty. The margin system should therefore reward customer service, to safeguard long-term sales and revenues.

Brand adequate presentation at the point of sale: With his appearance the dealer carries the image of a brand. This affects the corporate design of the dealer site as well as the provision of attractive demonstration cars and brand adequate customer support.

From the dealer's perspective a margin system should particularly fulfil the following requirements:

Fairness and performance orientation: The dealer margin is a remuneration which the dealer receives for carrying out his activities in automotive vertical marketing. Therefore basis of the dealer margin are the duties and standards laid down in the dealer contract. Fair and performance-oriented margin systems cause motivation and satisfaction of dealer networks.

Securing sufficient profitability: The dealer margin should provide the dealers with an adequate return on investment to finance future investments. The profitability is one of the most important drivers of dealer satisfaction (Meunzel, 2011, p. 3).

Stability, transparency and easy handling: The margin system should be calculable in the long term in order that the dealer can adapt his behaviour to comply with targets. Moreover the margin system should be easy to deal. The acceptance of margin systems is higher the more transparent and comprehensible they are for the dealers.

Avoiding intra-brand competition: The contract dealer has, due to his manifold bonding, particularly due to purchase relation to the manufacturer, hardly the possibility to differentiate himself from other dealers. Most of the times, this is only possible with price reductions. Hence the margin system shouldn't support intra-brand competition; if possible it should avoid it.

It is obvious that between the different requirements on margin systems there are various conflicts. Thus, the securing of a high degree of fairness can lead to the situation that margin systems become too complicated and difficult to handle. There are also conflicts between the requirements on a brand adequate presentation on the point of sale and the provision of a sufficient profitability. So, dealers often complain that margins are not sufficient to cover the costs regarding the manufacturers' requirements and standards. This leads to the conclusion that the ideal margin system doesn't exist. Each margin system is finally a compromise between different requirements which should be fulfilled.

8.3 Bonus-relevant Criteria

A common feature of the today practiced margin systems is the integration and increasing weighting of performance-based elements. This refers to all factors, which have a relation to the active sales performance of the dealer. This includes not only the quantitative characteristics of sales performance (sales volume, market share, etc.), but also the qualitative features (compliance with certain manufacturer standards, customer satisfaction, etc.). Figure 31 gives an overview of typical margin-relevant performance factors.

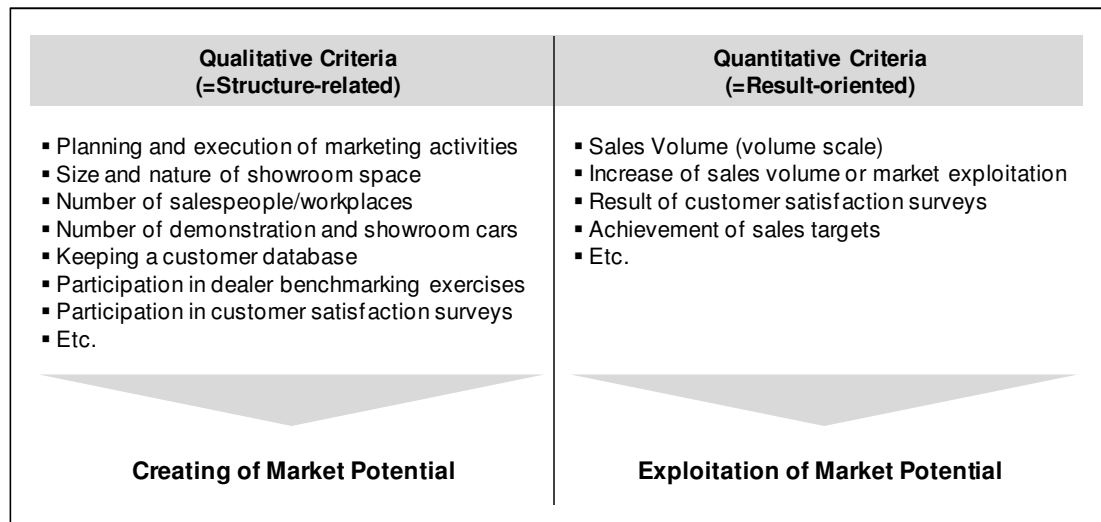


Figure 31: Performance Factors of Margin Systems (Diez, 2006, p. 339)

Basically a margin system can contain either more structure-related or result-orientated criteria. Structural factors are input-factors based on manufacturers' qualitative standards, which the dealer integrates into his business processes. It is expected, that the sales performance will improve due to such design factors. On the other hand the result- or output-oriented factors rely directly on the rendered sales performance.

8.3.1 Quantitative Criteria

From the manufacturer's point of view three indicators can be considered as quantitative criteria, although finally all criteria refer exclusively to the sold volume (Diez/Calles/Merten, 2004, p. 6). In this respect the absolute sales volume, the level of target achievement as well as the annual sales growth of a dealer can be used as calculation basis.

8.3.1.1 Absolute Sales Volume

The basic indicator for performance determination in sales is absolute sales volume. Therefore in the remuneration system of automobile manufacturers the sales volume represents a central role and is the basis for two important incentive components. On the one hand the base margin of a car dealer, as first variable remuneration, depends on the sale performance. With a constant relative margin the dealer receives an amount, which increases linear with the vehicles or spare parts sold. On the other hand the absolute sales volume of nearly all brands determines the height of the volume bonus. Here, the manufacturer grants the dealer an additional percentage discount, which usually depends on the achievement of a determined sales corridor. After exceeding a minimum volume a bonus is assigned to a certain turnover interval. It rises according to a quantity scale until the maximum amount is reached. But the volume bonus can also have a linear or progressive development. The measurement of the volume as basis for a bonus is characterised by high objectivity, reliability and validity. Moreover the sales result is transparent, easy to measure and can be directly influenced by the dealer.

8.3.1.2 Level of Target Achievement

Another criterion which correlates directly with the sales volume is the level of target achievement of planned sales volume per dealer. Basically there is the risk that managers assess the performance of their business incorrectly in the yearly planning with manufacturers. On the one hand this might be due to a wrong market assessment which can lead either to a too low or too high planning figure. On the other hand a dealer can plan too low, because thus he hopes to exceed the target more easily and to realize a successful year. In order to get as precise as possible information and planning figures, manufacturers introduced the level of target achievement as basis for another variable bonus payment to dealers. Dealers shall thus be motivated for a precise planning. Here it is less important whether the planned annual volume is high or low; it is about target achievement (Steffenhagen, 1995, p. 201). The potential bonus will be reduced by an underestimation as well as an overestimation of sales figures. This means, that also a too good performance will be punished. This is also the reason why such methodology is rejected by some dealers and also manufacturers.

8.3.1.3 Volume Growth

The third possibility to take the sales volume as basis for a variable monetary incentive is the volume growth. Here the bonus is granted on the basis of the dealer's sales or turnover change by comparing the reference year and the previous year. With a growth bonus the manufacturer wants to set an incentive for a continuous further development of the dealer. The development of this bonus is comparable with the volume bonus and starts with, for example achieving a minimum change and is then increasing either in intervals or linear up to a maximum value. In practice, car manufacturers often use a combination of both, absolute sales volume and volume growth.

8.3.2 Qualitative Criteria

Important qualitative bonus criteria in automotive remuneration systems are compliance with standards and customer satisfaction (Diez, 2006, p. 339).

8.3.2.1 Compliance with Standards

The definition of qualitative standards is used by manufacturers to coordinate and steer their dealers. Especially important performance criteria are linked with the margin and bonus system. This means, that compliance with such standards is used as an additional incentive criterion. A bonus can be based for example on standards to ensure that a company supports the brand image. Other criteria include the availability of showroom cars, specifications for sales and workshop workplaces, participation in dealer benchmarking exercises, the size and nature of showroom space, or attendance at mandatory training courses.

In order that a bonus is granted, a regular review of compliance with the standards is necessary. A positive auditing, which takes place in regular intervals, is necessary that the dealer gets his bonus payments. Due to the complexity of such an incentive system, the administrative effort increases for both manufacturers and dealers. On the other hand the standards can be measured objectively and can hardly be manipulated by dealers. Moreover the dealer can influence the target achievement. Such bonus criteria seem to fulfil also the requirements for objectivity and reliability. However, with regard to validity the question remains whether the manufacturer achieves what he hopes to achieve.

8.3.2.2 Customer Satisfaction

Customer satisfaction is another criterion used by many manufacturers as basis for dealer compensation. It is seen as a key influencing factor for the economic success of manufacturers and dealers. As already mentioned a positive relation between customer satisfaction and customer loyalty could be proved repeatedly. It must be a strategic goal of each manufacturer to achieve a high level of customer loyalty. To measure customer satisfaction and to transform it in a performance indicator, customers are interviewed regarding the tasks of a dealer. The customers express their opinion about the dealer performance based on a defined scale. According to the current legislation it is no longer allowed to merge customer satisfaction values from sales and service. The achieved level of customer satisfaction is the basis for granting of the bonus.

The application of both quantitative and qualitative factors has advantages as well as disadvantages: The reward of structure-related factors encourages definitely the long-term development of the business policy. The bonus gives an incentive to develop future market potential. On the other hand the bonus which relates to quantitative factors rewards the concrete sales success, which promotes the market exploitation. The different, but both important and necessary effects - creating market potential and exploiting market potential - speak for combining both margin elements. Depending on a manufacturer's strategy the one or the other elements can be emphasized stronger. For premium manufacturers the structural factors should definitely have more importance, while a mass manufacturer will probably put more weight on result-oriented factors.

Some margin systems contain an additional competitive element, as the amount of granted performance bonus payment doesn't depend on the achievement of an absolute, but relative performance level. So, for example, regarding certain bonus criteria the best 10 per cent of the dealers get the maximum bonus whereas the 10 per cent of the worst performing dealers get no bonus at all. Between these two points the bonus amount increases linear according to the ranking in the competition with the other dealers. This creates a performance competition among the dealers and there can be significant spreads for compliance with defined performance criteria (Diez, 2006, p. 339 f).

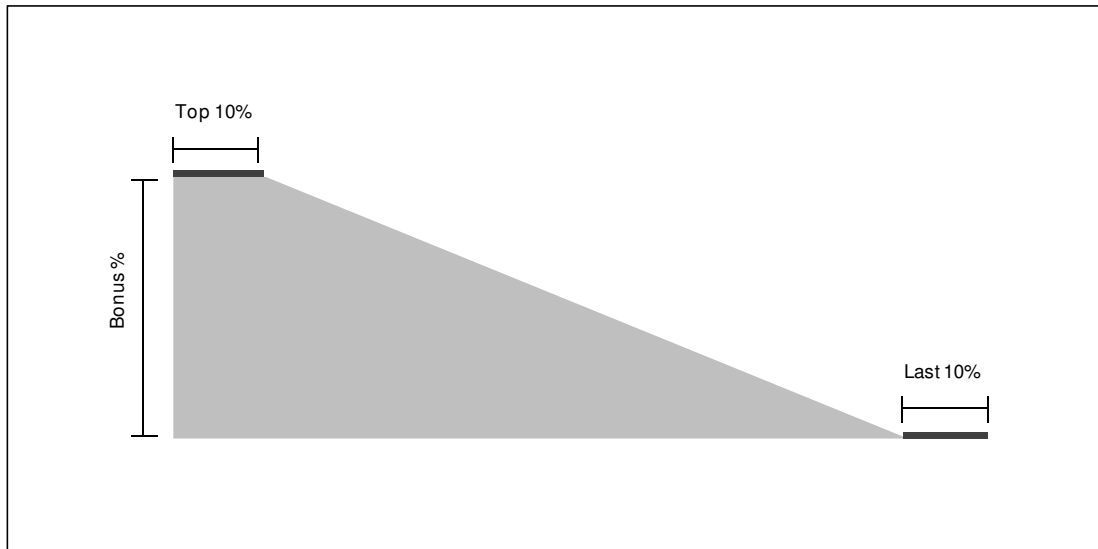


Figure 32: Bonus Function regarding relative Performance Level

Some car manufacturers increasingly started to incentive loyalty with their bonus programs. They rely on customer retention and conquest bonus payments, which should lead to increased market exploitation by dealers (Merten, 2010a, p. 14). They use dealer loyalty scorecards as a factor determining dealer compensation (Polk, 2010, p. 2).

8.4 Evaluation of current Margin Systems by Dealers

From the car dealer's point of view the practiced margin systems have several weaknesses. Often the lack of transparency and the complexity of margin systems are criticized. Another point of discussion is the bonification of customer satisfaction. When assuming that customer satisfaction is a holistic construct, many dealers fear that they are made responsible for errors of the manufacturer, if their bonus depends on the overall level of customer satisfaction. So, a customer will be hardly satisfied with a dealer, if he has massive quality problems with his vehicle or the promised delivery date is not met. It is also noted critically that the bonification of customer satisfaction opens up certain possibilities for manipulation. Thus the salespeople can certainly influence the judgement of the customers by promising monetary or non-monetary benefits when providing them with a favourable judgement (Reichheld, 1997, p. 60 f). Prof. Diez stated that it is well known that many dealers "steer" their customer satisfaction (Plate, 2011, p. 14).

Beside the structure, often the absolute margin is criticized by dealers. In particular it is noted, that the amount of the basic margin or effective margin is not sufficient to

work profitable in new car business. Whereas it has to be taken into account, that beside the margin also other factors influence the profitability of new car business, which are rebates to customers and the sales volume as well as cost-relevant standards (Diez, 2003, p. 16 f).

A recent survey shows that more than half of the dealers is less satisfied or even dissatisfied with the margin system of their main brand, and each second dealer rates also the total margin pessimistic (Meunzel, 2010, p. 11 f). Larger dealers with more than 250 new car sales per year tend to be more satisfied with their margin system than small or medium-sized dealers. Important performance-criteria for the dealers, which a margin system should include, are sales volume and target achievement. Therefore volume bonus payments are appreciated by most of the dealers. Dealers evaluate number of staff and mystery shopping as the least significant calculation criteria.

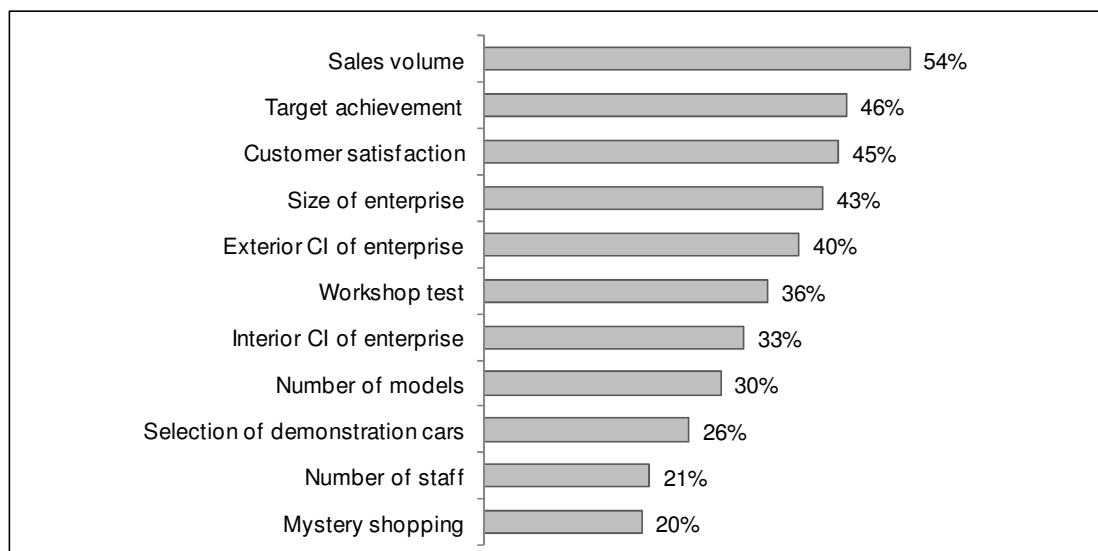


Figure 33: Margin Elements: Rating by Dealers: Which criteria should be included in Margin Calculation? (Meunzel, 2011a, p. 33)

Dealers rate the simplicity of their current margin system worst. In this respect only five per cent evaluate their margin system as very good and 23 per cent as good. Simple recording and calculation are most important requirements of dealers on margin systems. Currently on average 73 per cent of the dealers see need for change of their margin systems. According to the respondents for the introduction of a new margin system improvements should be made regarding the simplicity of data recording and calculation, better planning accuracy, restriction of intra-brand competition and transparency. Customer satisfaction as margin component is seen positively only by 20 per cent of the respondents.

Margin systems should increase the profit per sold unit. At the same time it is necessary to lower the ruinous competition. Future margin systems should therefore help to meet these requirements. Examples for such approaches are the remuneration systems of Volkswagen and Audi with a customer loyalty bonus (Meunzel, 2011a, p. 33).

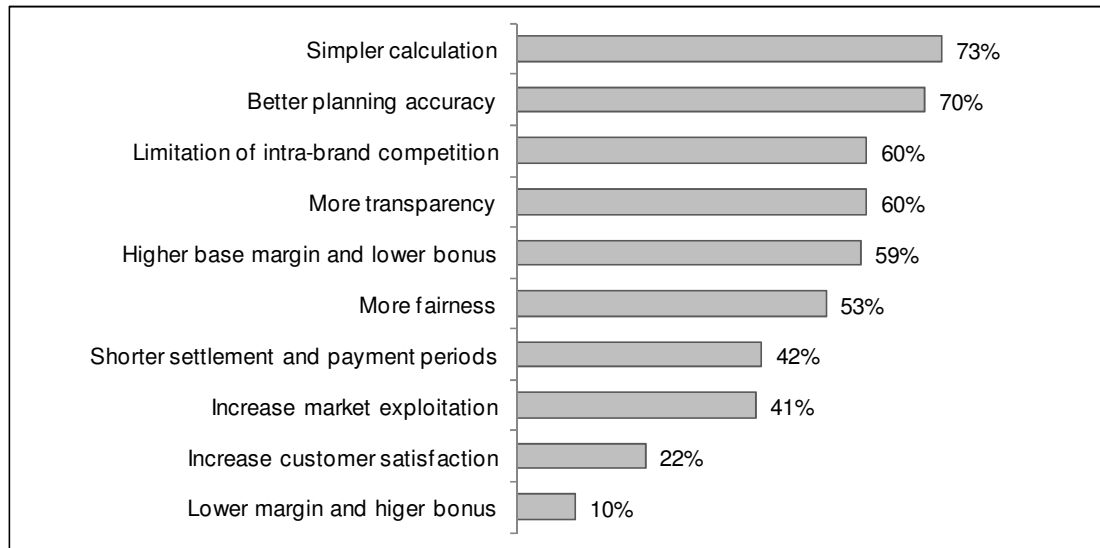


Figure 34: Requirements on Margin Systems from Dealers' Perspective (Meunzel, 2010, p. 16)

8.5 Example for Spare Parts Margin and Bonus System

The bonus systems regarding spare parts business used by vehicle manufacturers generally utilize schemes such as bonus payments, which depend on amount (value or volume) of parts sourced from the vehicle manufacturers. These schemes can be linked to the volume or value of captive or non-captive parts, bought from the vehicle manufacturer and incorporate incentives which lower the authorized dealers' willingness not to buy parts outside the vehicle manufacturer supply channel. Examples of such rewards systems include special bonuses if a certain percentage of "competed" parts is bought from the vehicle manufacturer, year-end bonus for high purchases of vehicle manufacturers' parts. Generally, such schemes are geared towards encouraging the purchase of non-captive parts (LE, 2006, p. 253).

OEMs attempt to increase their sales to the independent aftermarket through bonus schemes that support their authorized dealers in this business. Also spare parts business with fleet customers is supported by OEMs. Moreover there is a kind of functional bonus which is paid to the dealers for automatic delivery at defined time-intervals for stock orders. Also time-related discounts and customer satisfaction can be part of the bonus system.

		2. Dimension of Margin System		
		Dealer Segmentation A/B/C		
1. Dimension of Margin System	Differentiation by Volume/Function/Time/Customer/Product Group	Type of discount	Basis	Condition
		Dealer Base Margin	Remuneration of standard performance	Depending on product group: Captive parts: 10% - 30% Competitive parts: 30% - 55%
		Functional Bonus	For automatic delivery at set time-intervals (parts for routine servicing and repairs (e.g. filters, brake pads) (to influence ordering and stock keeping)	Up to 5%
		Customer Satisfaction Bonus	Level of customer satisfaction	According relative performance: Up to 3%
		Volume Bonus	Purchase quantity	Discount scale: Up to 3,5%
		Competitive Parts Bonus	Defined competitive assortment	Up to 10%
		Time-related Discounts	Forward buying for seasonal sales promotions and stock keeping for these products: autumn/winter and spring/summer promotions	5% - 10%
		Customer Groups	Turnover of authorized dealers with fleet, customers or independent garages segment, vehicle age	Depending on product group: Up to 10% Extended warranties
		Payment Terms and Vendor Financing	Term of payment Inventory financing	Interest advantage for up to 6 months 0,5% - 1,5%

Figure 35: Example Spare Parts Margin and Bonus System

8.6 Establishing a Bonus System

OEMs cannot afford to lose ground in the aftersales business, because the higher margins are necessary to compensate for low profitability in new car business. The aftermarket is of particular importance to dealers in two respects: with new vehicle demand falling and the average length of ownership on the rise, there is significant potential in the aftermarket business which needs to be captured by dealers, and as competition in the aftermarket increases it is becoming a necessity for authorized dealerships to build customer loyalty. Due to these facts it is also important for manufacturers to build strong ties with their own sales channel.

The design of a bonus system requires clear objectives. The overall objective of the compensation system in the sales channels of automotive industry is to encourage dealer activities which are in line with the manufacturer's goals and contribute to its success. Primary objective of most OEMs is to maximize market exploitation by increasing sales volume and turnover. In spare parts business an important indicator is the average turnover per vehicle in the car park.

Automakers should create a bonus system that promotes desired dealer behaviour and performance levels. Such a system must reflect the reality that dealers can only focus on a limited number of criteria, and that need to be sufficiently important to influence dealer's retail behaviour. As a result, bonus plans need to concentrate on result-oriented criteria (e.g. conquest and retention rates) that increase profitable sales, and should put less emphasis on hygiene factors, such as customer experience or retail standards. Hygiene factors are typically covered in the dealer's contract. Making them part of the bonus system might distract dealership staff from the original goal, which is to sell the products at the required volumes to increase market exploitation and to maximize the contribution margin. Hygiene factors should be rather qualifiers to receive a bonus.

Moreover when establishing a bonus system, the manufacturer needs to make sure to apply equal levels of "stress" across dealers. To ensure equal stress levels the structural differences, historical dealer performance and size of dealers have to be taken into account when determining targets, bonus levels and scales. This is important because the perceived effort to achieve a revenue threshold affects the perceived fairness of a system (Fassnacht/Winkelmann, 2006, p. 469) and influences the motivation of dealers. By more differentiation regarding dealer size it is possible to address more the performance orientation and the effective sales performance of

the dealers. Higher sales performance will then be remunerated with higher margins.

In spare parts business with the determination of the dealer purchase price and the achievable bonus payments for spare parts the manufacturer exerts direct influence on the financial attractiveness of spare parts which dealers associate with the business relationship. Therefore with an attractive design of the relevant parameters the economic satisfaction and economic bonding of the dealers can be increased.

In this context manufacturers can, apart from adaption of dealer purchase prices, resort to the introduction of volume and loyalty discounts as well as to individual arrangement of terms and conditions. Instead of solely lowering the dealer purchase price, manufacturers should focus on advanced pricing models and introduce measures targeted to certain price segments, such as life-cycle pricing and price bundling. Spare parts should be categorized according to the major contributors to its customers' and dealers' price sensitivity: the part's value and its competitiveness, or captiveness. In segments with high price sensitivity, competitive pricing is crucial to win back cost-conscious customers in order to make more volume, while in less price-sensitive segments companies can apply higher mark-ups (BCG, 2009, p. 7).

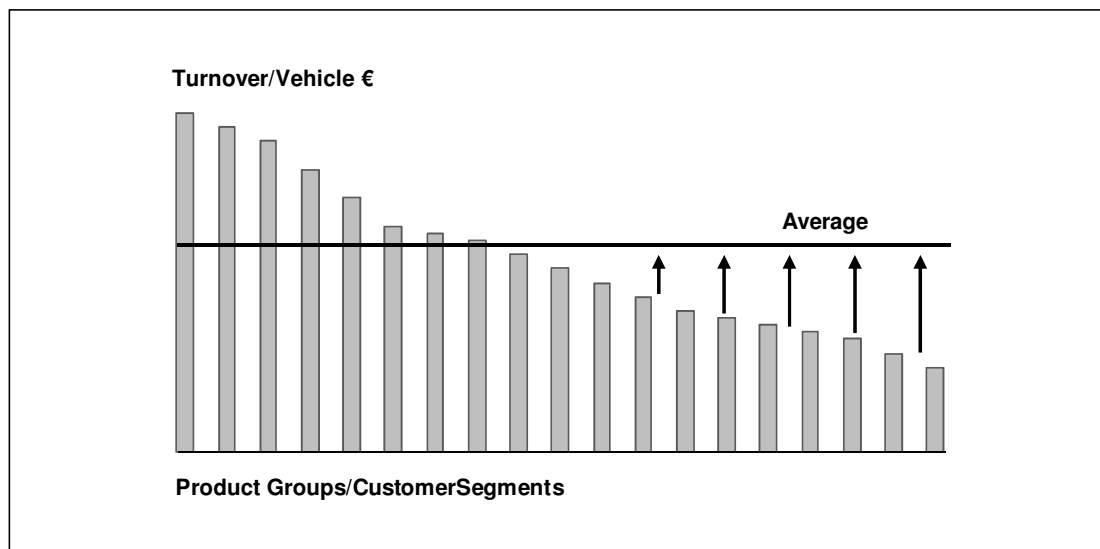


Figure 36: Unexploited Market Potential (schematic)

In this respect automobile manufacturers should differentiate targets by setting them on product or product group level but also on customer group level. Incentives to support market exploitation should be well directed to product groups/customer groups with potential in order to increase market exploitation and the average turnover per vehicle in the car park. The underperforming product groups with respect to

dealer purchase loyalty must be measured and identified in order to support them with targeted incentives. Figure 37 shows that there is a significant loyalty spread between the different product groups.

Therefore car manufacturers should, beside an individualisation of the design of terms and conditions, take into consideration a special price and product policy for spare parts for older vehicles. Since this is the fastest growing segment of the car park, it is necessary to create an adequate offer for this segment. So, as already mentioned, some car manufacturers want to increase the economic satisfaction of contract dealers with the introduction of a second brand trade mark for the market exploitation of the older car segments. It is assumed that lower prices for these segments in comparison to original spare parts will increase capacity utilisation in the dealers' workshops and will finally have an impact on dealer satisfaction with OEMs. Thus also the dealers' loyalty is strengthened, because dealers now are often forced to switch to cheaper offers from the independent aftermarket in order to provide the end-customer an adequate residual value-based offer. Moreover dealers' turnover in this segment could be further remunerated by OEMs with a bonus criterion that takes into consideration the volume growth or conquest rates in this segment.

Many original owners change their garage already when the warranty or goodwill period expires. This loyalty dip in the middle-aged car segment occurs for all OEMs. Consequently, system chains and other independent service providers catch up in market share the older the cars get. Here OEMs can use the strategy of price bundling with the aim to increase customer retention. A way to meet customers' needs is to offer service packages at fixed monthly rates or to offer maintenance agreements connected with new car sales. This is especially interesting with regard to fleet business which is growing at above-average rates. OEMs can support customer retention and dealer loyalty with the offer of extended warranties which go beyond the legal obligations. Here again all these offers will increase the customer loyalty to contract dealers and represent also financial support of OEMs to their authorized dealer network. It is reported, that Kia who introduced a 7 year guarantee, could significantly increase the authorized-workshop loyalty for 3 year old cars from 30 per cent up to 65 to 70 per cent (EurotaxGlass, No. 2091, p. 3).

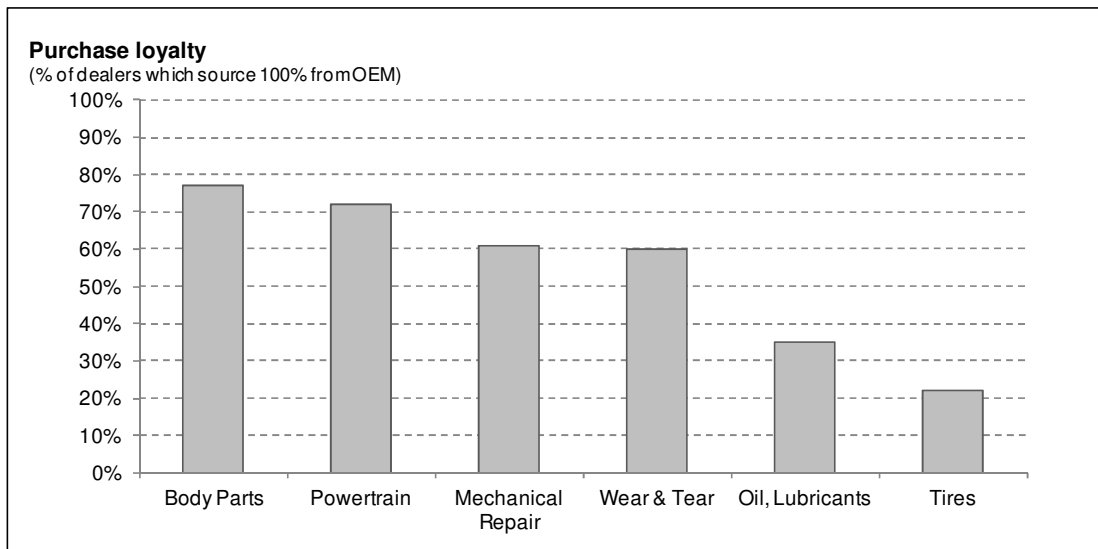


Figure 37: Dealer Purchase Loyalty in different Product Groups (source: Volkswagen AG)

An important factor whether incentive programs show their desired effect, is the way how they are communicated. In practice it can be said, that parts ordering systems tend to hide effective prices and show list prices instead. The numerous yearly bonuses and rebates as for example shown in figure 35 cannot be seen. This lack of price transparency causes that dealers consider parts prices as too high, which leads as a consequence to unforeseeable ordering decisions by employees in after-sales. It is important that the incentives are communicated clearly and that also the systems show the effective purchase prices which will help to improve the perceived OEM spare parts price image and dealers will have a better overview regarding the profitability of spare parts.

8.6.1 Management Process for Bonus Systems

The previous chapters describe objectives, contents, requirements and conditions of bonus systems. After the theoretical design the so defined steering instrument has to be implemented into practice. This requires the consideration of an appropriate implementation and management process. Therefore the main process steps are conception, planning, implementation and control. It has to be determined how each stage should be designed to achieve the intended effect as steering instrument in accordance with the objectives. In the following the single process steps will be explained. Main focus will be put on the controlling phase, because its results are the starting point for the continuous development and improvement of the margin and bonus system.

If a bonus system should act as a steering instrument, then on the one hand it must react flexible to a changing business environment and on the other hand it must be adaptable to target deviations. This means in the context of the management process that observed deviations at the end of the business process (controlling) are fed back to the beginning (conception) to initiate appropriate regulatory measures.

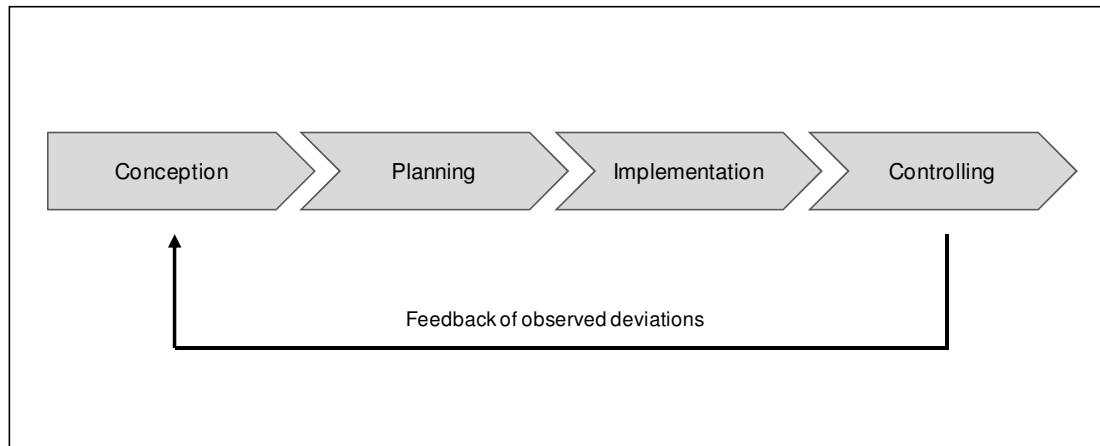


Figure 38: Management Process for a Bonus System

8.6.1.1 Conception

The first phase of the management process refers to some basic decisions. Beside the definition of the main targets of the bonus system, it has to be determined who has to be integrated into the incentive system. However due to legal reasons all automotive dealers of one brand must be given access to the remuneration system. The design features of a condition and bonus system must meet internal requirements as well as implementation requirements of dealers. In the context of the conception of the bonus system it is also appropriate to provide possibilities for participation, which increases the motivation of the involved parties. An increased acceptance of the system leads to stronger commitment, which in turn is the basis for higher performance (Lawler, 1990, p. 11).

Therefore already in the conception phase sales field staff should be involved. Their input is very important, because they know the dealer organization very well. They have fresh field information on market potential, which can be used for planning and control purposes. Also selected dealers should be involved early in the concept phase. In this concrete case of designing a bonus system in the automotive industry, the dealer associations which represent the dealers' interests should be involved as soon as possible in the conception of the bonus system. This will help to prepare an smooth implementation phase and provide the basis for an ideal performance after the introduction of the system.

Moreover the dealer structures in terms of their group- and cooperation linkages have to be recorded as well as their actual turnover and condition range. This data base can be used for computer simulations regarding the effect of the new condition system. As a result winners and losers of the new system can be identified. Only in this way customer specific measures can be developed and expectations on winners can be communicated. Possibilities can be shown to losers through which behaviours they can improve. If the individual system components are jointly agreed upon with the dealers, there is lower risk that a new system is not accepted (Simon/Fassnacht, 2009, p. 384 f).

8.6.1.2 Planning

In the planning phase the objectives of the bonus system which were defined in the conception phase will be converted into concrete guidelines and work steps. In particular the duration of the bonus system and its linkage with the budget are to highlight. The time horizon specifies the validity of the bonus system. Since it is a contractual regulation it must be determined how long the agreed system will be valid. In this context the possibilities can reach from a yearly revision of the system to an unlimited validity. After the planning of the content is completed, the bonus system must be linked with the budget to ensure a regular payment of granted bonuses. Success requires OEMs to make sure all elements of the bonus system are clearly defined, can be tracked, and are target oriented, i.e. that dealers focus on the most relevant actions.

8.6.1.3 Implementation

The implementation phase is characterized by two main topics. On the one hand the information and communication of the bonus system is very important, because it influences the impact of the system considerably. Through comprehensive information the rules of the bonus system will become transparent and hence comprehensible for the incentive recipient. This supports the sense of justice of the actors and promotes the motivation for target-oriented actions. A prerequisite for effective information is the execution of appropriate communication activities. With regard to the particular situation of the contracted dealers, personal contact should be preferred to group events. With prepared documentation the characteristics of the system and expected financial implications can be explained to dealers. The measures which are taken to improve the margins should also be communicated actively by field staff.

On the other hand the implementation includes also the regular reporting of the agreed performance criteria and the resulting bonus compensation. Also here, it is to keep the motivation of the players at a high level. This is achieved by a high-quality data base for performance measurement, which leads to individual feedback rounds and the cooperative agreement of performance-enhancing measures. Moreover reliable payment processing will contribute to a higher satisfaction with the bonus system and its effectiveness.

8.6.1.4 Controlling and Year-end Ranking

The controlling function as part of the management function is understood as „monitoring and adjustment of organisational activities“ with respect to the defined objectives (Staeble 1999, p. 544). Prerequisite for control is the existence of detailed objectives and their measurability. The definition of objectives is part of the conception phase and sets the standards for measurement of the control results. The implementation phase shows the results which can be achieved. After recording the actual data the deviations can be analysed. On the basis of the recorded positive and/or negative deviations, corrective measures on the input parameter can be made. This represents the feedback from controlling to the first phase of the management process.

Now the question is how to measure the performance which is the basis for deviation analysis and finally results in an adjustment of parameters. Steering a business requires a key performance indicator (KPI) “cockpit” (BCG, 2009, p. 8). A well-known example for the application of performance measurement is the retail balanced scorecard. The balanced scorecard can be understood as an integrated strategy- and target-oriented management system, because it balances KPIs from different areas of a company to a common concept (Lindert, 2001, p. 129). It designs the management process. Basic idea is to use different views to determine the performance of organizational units from four perspectives: financial, customer, internal business process and learning and growth. These four perspectives provide the framework for concrete KPIs (Kaplan/Norton, 1996, p. 8). The concept combines therefore quantitative and qualitative, short- and long-term, monetary and non-monetary as well as external and internal performance criteria. It thus includes all major types of performance indicators that are used in automotive incentive systems and is therefore a suitable instrument for a structured control of the success of the bonus system.

The success and effectiveness of the bonus system are measured on the basis of defined criteria. The degree of fulfillment must be measured regularly and fed to a variance analysis. The criteria comprise on the one hand the planned budget and on the other hand also for example the objectives regarding sales volume. These are at the same time the performance criteria which are used in the dealer incentive system. If the indicators are calculated for each dealer, the same scorecard can be used in the implementation phase for performance measurement of contract dealers and for structured presentation of dealer performance. By linking the different indicators or weighting of different indicators, OEMs receive an innovative steering instrument for the management of the incentive system.

9 Conclusion

In the context of this work the special features of automotive distribution, the strictly defined parameters in the form of dealer qualitative standards as well as the margin and bonus system as part of the contractual relationship could be worked out. The margin and bonus system is the central monetary incentive system of manufacturers to steer their dealers and represents the dealer's remuneration for his tasks in the sales and aftersales process. The legally allowed scope of action for dealer management is thereby determined by European competition law, in particular by the so-called Block Exemption Regulation.

By strengthening dealer purchase loyalty manufacturers want to make sure that dealers don't switch to other suppliers but also that dealers increasingly buy from them so that manufacturers' revenues and contribution margins go up. This is an important strategy since the research on the automotive aftermarket shows that service needs per vehicle are declining and at the same time intensity of competition between manufacturers' and independent channels is increasing.

The key determinants of customer retention and loyalty were outlined, which are in particular commitment, trust, satisfaction, habit, switching costs as well as the knowledge of alternatives. Moreover, loyalty is influenced by the position of a customer within a business relationship, which is if a customer must stay or wants to stay within a business relationship. If a customer is dissatisfied in a locked-in situation, this bears risks as soon as for example the environment or legislation changes.

Dealer satisfaction could be identified as a key determinant of the manufacturer-dealer relationship influencing dealer loyalty. The earning and profit situation is reported to be one of the most important drivers of dealer satisfaction. Therefore dealers must be provided with adequate funding and spare parts bonus structures in order to secure their profitability.

In order to act as an effective management steering instrument, the margin system must be carefully designed and has to fulfil a number of different requirements. In this respect in the literature are stated requirements such as transparency, fairness as well as securing a sufficient profitability for dealers. Other important features are the design elements and criteria which have to be defined accurately to promote the desired dealer behavior in the line with manufacturers' corporate and strategic goals.

Customers of older vehicles where manufacturer's market shares have eroded, must be addressed in a targeted manner and incentives given to dealers to exploit this potential. Extended warranties, segment- and current-value-justified prices for parts and intelligent bundling of products and services will strengthen customer loyalty and dealer loyalty as well. Such price strategies combined with an active price and bonus communication can win back the cost-conscious customers/dealers and form the basis for reinforcing the parts business over the long run.

The use of professional tools and implementation methods and monitoring can ensure that the parts business remains a stable earnings pillar for vehicle manufacturers. Such an implementation and steering process is shown on the basis of a management process. It turns out that information and communication are key success factors in the designing and implementation phase of a remuneration system. The controlling phase is to prove the efficiency of the implemented bonus system and is also intended to provide feedback to the conception phase of the management process.

Additionally to monetary incentives, car manufacturers can successfully counteract a possible erosion of spare parts with improvements of the system-offer, because beside the parts price also the logistic service quality, a good electronic catalogue, and high parts quality are important decision-making criteria for authorized workshops when choosing a parts supplier or distributor. The continuous improvement of this system-offer and an active parts business strategy will contribute to safeguard the manufacturers' market leadership in aftersales service.

Appendix

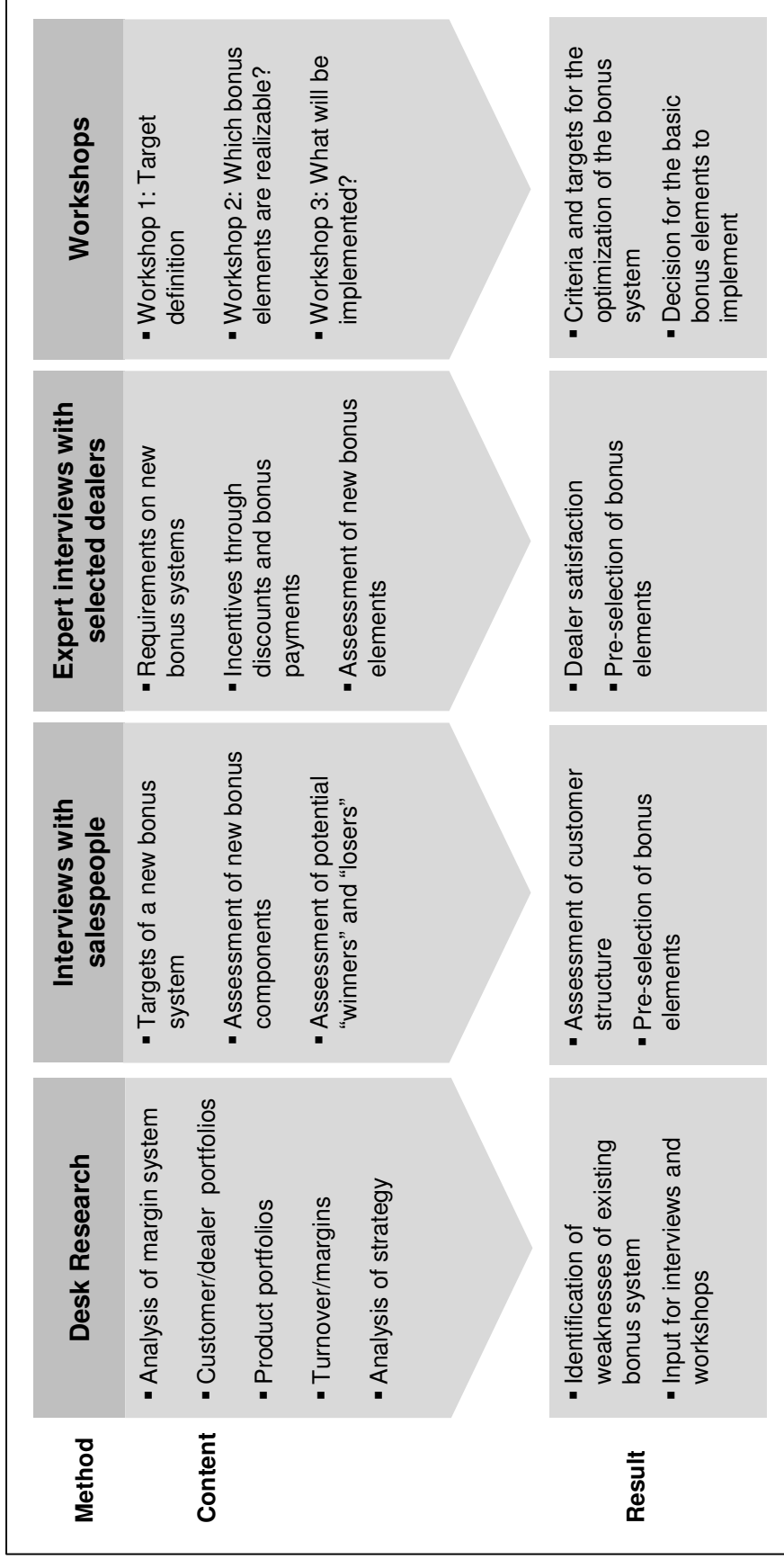


Figure 39: Analysis and Conception of a Margin and Bonus System (according Simon, Kucher & Partners)

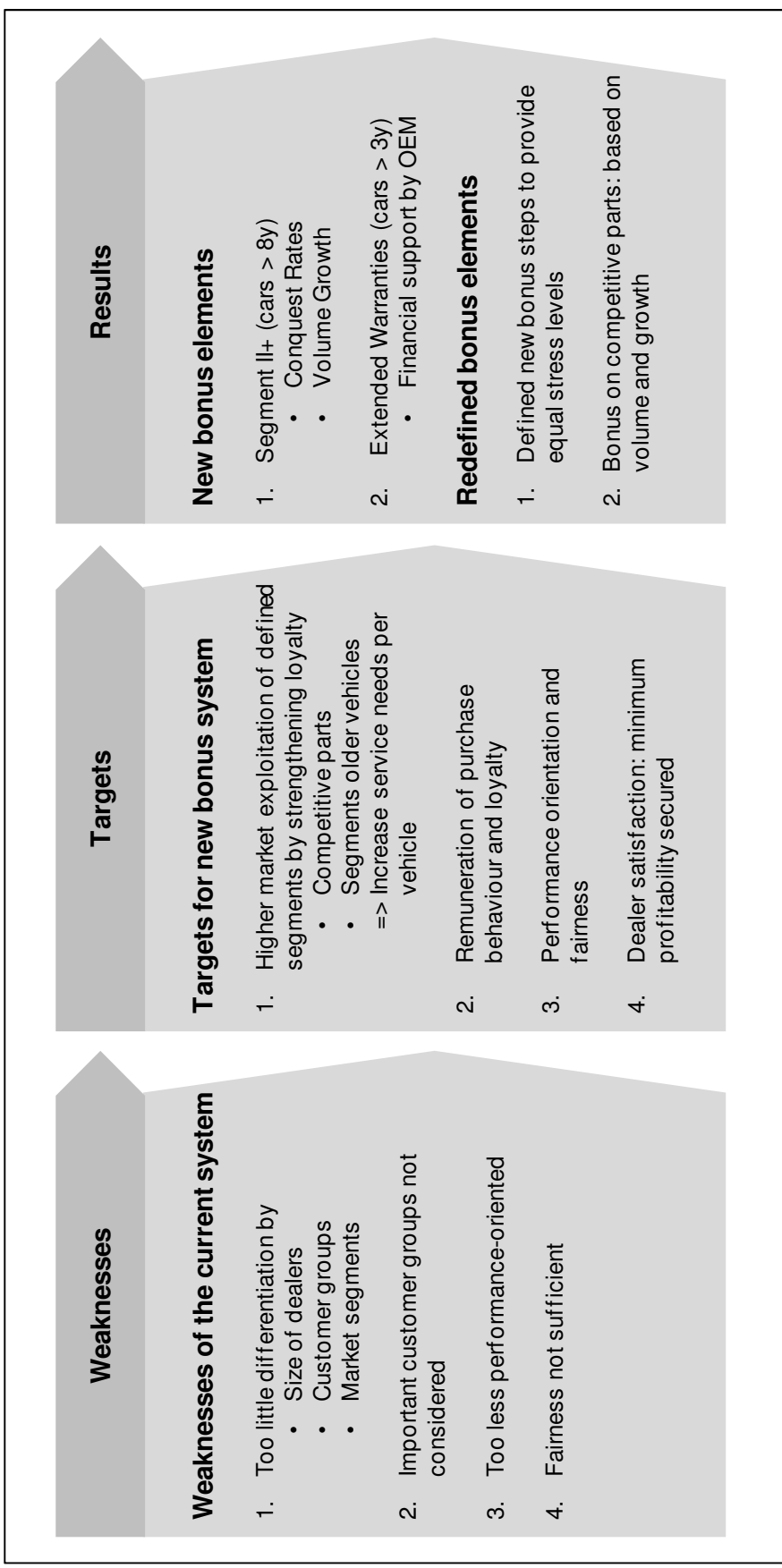


Figure 40: Example of a Process: Identifying and Defining Weaknesses – Targets – Results of a Bonus System (adapted from Simon, Kucher & Partners)

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