

AUTOMOTIVE DEALERSHIPS IN CHINA

ACCELERATING PERFORMANCE

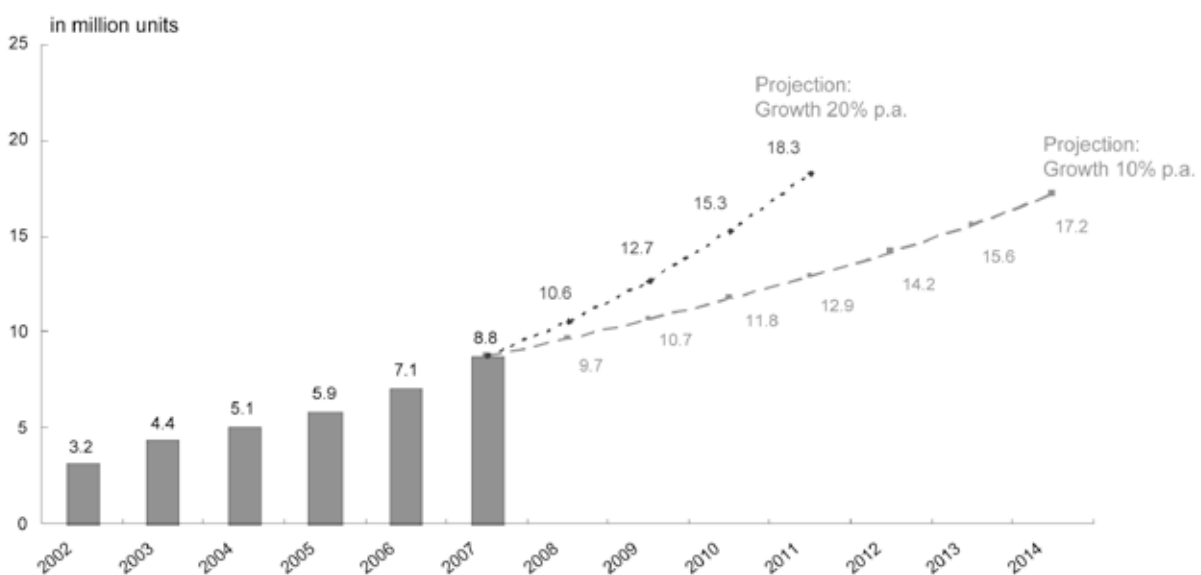
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THE CHINESE AUTOMOTIVE MARKET - A SUCCESS STORY IN THE NEW MILLENNIUM

In recent years, China has surpassed Japan and the major European car markets, and rapidly become the second largest automotive market in the world. Only in the United States of America are more vehicles sold every year, and even this will change in the future. With a projected annual growth of approximately 20%, China is destined to become the number one auto market in the world within the next three years. Indeed, even with far more conservative expectations, the “Middle Kingdom” will gain the global top spot not later than 2015 (see figure 1).

What makes China so outstanding among all major auto markets is the tremendous growth of the passenger vehicle market, combined with the immense potential for further development. The increasing economic prosperity enables more and more households to purchase passenger vehicles, providing mobility and freedom to move around, as well as offering a way to display success and elevated social status. The fast expansion of the passenger vehicle market (cars, MPVs, SUVs)¹ is driven by first-time buyers who are purchasing an automobile for the first time in their life for private purposes. These buyers account for 70% of new vehicle sales in China.² This substantial addition of new cars over recent years has increased the share

FIGURE 1
DEVELOPMENT OF CHINESE AUTOMOTIVE MARKET



of passenger vehicles among all automobiles in the market (including trucks and buses) to almost 60% in 2007, from a level below 40% five years ago. The forecasted Gross Domestic Product (GDP) growth over the next three years of an average 8.4%³ and the projected increase of household incomes will support the continued expansion of the passenger vehicle market in the near future.

As one of the fastest developing car markets with huge potential for further growth, China has attracted virtually all car manufacturers to produce and sell their vehicles on the mainland.⁴ China has rapidly transformed from a “seller’s market” into a “buyer’s market” in which consumers can now choose among more than 60 car brands. The “Middle Kingdom” has therefore become the most competitive car market in the world - a fact which poses particular challenges for marketing strategies of car manufacturers, including the management of their distribution networks as well as individual dealer performances.

China has become the ticket to success for many international car makers, allowing them to compensate stagnating or even declining sales elsewhere. General Motors and Ford, for example, struggling with their respective brands in their home market, have established flourishing operations with their Joint Venture (JV) partners in China. Volkswagen, the longest standing foreign player on the mainland, has accomplished record sales in 2007, making mainland China the most important market outside Germany.

The Chinese passenger vehicle market is also a success story for Chinese car manufacturers. Within only a few years, several domestic car manufacturers like Chery, Geely, and Lifan have successfully developed own vehicles and materialised substantial sales without any cooperation with international car makers, Chery deserves particular mention, as it has become the fourth largest car manufacturer in terms of sales, after Volkswagen, General Motors, and Toyota. Altogether, Chinese car brands own approximately 30% of the passenger vehicle market in their country.⁵

THE ROLE OF CAR DEALERSHIPS IN THE DISTRIBUTION SYSTEM

In all markets car dealers play an essential role within a car manufacturer’s distribution strategy, because they ensure the sales and after sales service of the vehicles to end-consumers. In China, car makers rely mainly on 3S and 4S dealerships⁶ which cover the relevant geographic regions, and are mostly run by independent entrepreneurs. Following a government regulation in 2005 to professionalize the automotive distribution (“Implementation Measures Governing the Sales of Brand Autos”)⁷ all car dealers must receive authorisation from car manufacturers to sell cars and provide after-sales services. This regulation has led to the exclusion of traditional small and independent car distributors, and given car makers a better control of their distribution networks. As they increase the number of sales outlets in order to respond to growing market demand, all car manufacturers face the challenge of ensuring a consistently high level of sales and service performance across their dealer networks.

To lay the ground for successful operations, car manufacturers have to offer consumers (and their dealers) attractive car models and competitive prices, as well as establish appealing brands in the market place. Car dealers, on the other hand, manage an essential part of the interaction with end-consumers and significantly impact customer satisfaction and brand perception. Their task is to “translate” vehicle manufacturers’ marketing activities into optimal customer service. The better car dealers understand what consumers are looking for when buying a car, and the more accurately they are able to anticipate changes in demands, the more successful their operations will be. However, dealer activities are not limited to the sales of new cars to new customers: Ultimate success will be achieved by accompanying customers throughout the consumption life-cycle, and, thus, ensuring repeat purchases in the long-term. In this sense, the quality of dealer performance plays a critical role in the purchase decision process, and is essential to win and retain customers.

ESSENTIAL ASPECTS OF CONSUMER DECISION MAKING

At the beginning of each purchase decision process is the need to solve a problem, i.e. to eliminate a discrepancy between a desired state and an ideal state. The entire consumer decision making can be divided into four steps (Perner, 2007):

1. Problem recognition: Something is not as it should be.
2. Information search: What are the alternative ways to solve the problem?
3. Evaluation of alternatives: Which alternative solves the problem best?
4. Purchase stage: A certain alternative is chosen.

In competitive markets where many products battle for market shares and market offers tend to become interchangeable, individual product features alone cannot ensure sustained success. The notion of a brand gains particular importance as each brand represents a mass of information that helps consumers make a product selection more quickly (Peter and Olson, 1994). Purchase motivations are driven by emotions as well as rational considerations (Kroeber-Riel, 1992), and product attributes, price evaluations as well as the brand are critical determinants for purchase decisions. As market structures become more complex, products are differentiated through more sophisticated branding. Brand names and brand images serve as reference for decision making, while brand values and brand personalities enable increasing emotional relationships between brands and consumers, up to an iconic stature of the brand (Goodyear, 1996).

In modern economies, well established brands are indispensable for sustained market success, as they not only help to attract new customers but also set the basis to establish loyalty among existing clients. This is particularly true in the highly competitive automotive industry. While car manufacturers build, grow and develop brands, car dealers “deliver” them to the end-consumers. In this sense, car dealerships are the guardians of the car maker’s brand promise.

Due to its generally elevated amount of investment, buying a car is considered as an act of high involvement, and consumers attach great importance to making the right purchase decision. The process of decision making whether to buy a vehicle, and, if so, which brand/model and where, is influenced by various factors. They include physical aspects (e.g. mobility), social factors (e.g. reference groups) as well as cultural influences (e.g. values). Consumer behaviour is also influenced by learning, i.e. the level of experience available (Perner, 2007).

PARTICULAR CHALLENGES FOR CAR DEALERSHIPS IN CHINA

From a conceptual point of view, as discussed above, there is no reason to believe that the Chinese market would omit the typical stages of development, and Chinese car buyers would act completely differently than consumers in other markets. Nevertheless, social structures and cultural values differ from other regions and impact consumer behaviours. The economic context is not the same as in other countries. A stable GDP growth and fast increasing prosperity tend to accelerate market progress and maturity. Furthermore, the Chinese market character is affected by influences from various mature auto markets in the East and West as well as from a strongly developing domestic car industry. The combination of these factors sets China apart from other promising auto markets like Brazil, Russia and India, and makes it a unique market place where car makers and their dealers face specific challenges.

From the point of view of consumer behaviour, China must be still seen as an emerging yet fast evolving automotive market. Typical for a developing car market, functional product features are of essential importance for the purchase decision. Sedan cars are omnipresent, as they correspond best to the basic needs of car owners: The vehicles are relatively large and safe, offer sufficient luggage space, and are comfortable for ingress and egress. Size, safety and functional practicability as well as the motivation for showing off success figure among the most important purchase factors for automobiles.⁸ Brand considerations, compared with

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more mature markets, still play a less important role. However, trend analyses indicate that market offers and consumer behaviours expand quickly and become more sophisticated.

In this context, automotive dealerships in China are confronted with the following issues with regards to car purchase and customer service:⁹

- Due to little car experience in the market, car buyers rely heavily on advice and recommendations.
- The internet plays a significant role in the purchase preparation.
- Product information is essential for the purchase decision while brand commitment evolves only slowly.
- Demand for advanced client offers such as car financing and extended after sales services are still negligible.

IMPORTANCE OF RECOMMENDATIONS AND ADVICE

As China’s passenger vehicle market is still quite young and driven by a high share of consumers who purchase a car for the first time, it is hardly surprising that the level of experience among these first-time buyers is relatively low. Therefore, during the purchase decision process, they rely heavily on advice and recommendations. The latter are above all sought from family and friends. Overall, for half of new car buyers private recommendations figure among the most important purchase criteria, and every fourth car

buyer chooses the dealership where the vehicle was finally bought upon specific recommendation.

On the other hand, in terms of advice, consumers have apparent reservations towards salesmen. Only one out of ten motorists states good advice at the dealership as one of the major reasons for purchasing the car (see table 1). The main cause for this lies in the fact that numerous sales people are only little automotive experienced themselves, and can rarely impress customers with comprehensive product information. Car buyers perceive advice from salesmen much less informative and credible compared to recommendations from friends and families.

SIGNIFICANCE OF THE INTERNET

In addition to the rather traditional methods of obtaining advice and recommendations Chinese car buyers notably use the Internet to collect information for the preparation of a purchase decision. In particular they browse car-dedicated websites, read related news, compare prices and participate in web discussions. Four out of ten consumers acknowledge that the Internet is extremely or very important, while almost 25% of respondents judge information from the Internet as being very credible (see table 2).

Information available on the World Wide Web has made the marketplace much more transparent for consumers, and has major implications for car manufacturers as well as for car dealers. The opportunity for consumers

**TABLE 1
MAIN REASON FOR CAR PURCHASE AT THIS DEALERSHIP**

Attributes	Most influential factor	2 nd most influential factor
Recommendations from friends/ acquaintances	26%	11%
Availability of preferred brands	18%	14%
Good service quality	17%	21%
Convenient location	15%	9%
Low prices	12%	11%
Good advice	6%	5%
Wide range	4%	5%
Close customer relations	3%	6%

TABLE 2
RELIANCE ON INTERNET CONTENT AS SOURCE OF CAR PURCHASE INFORMATION

Extremely and very important	40%
Credible (Top 2 on 10 point scale)	23%

to connect with unknown people through web chats and blogs increases the significance of advice and recommendations, as it is quite easy to make individual experiences available beyond the scope of personal friends and acquaintances. Every single dealer visit therefore becomes extremely critical since positive word-of-mouth can have a multiplying effect to bring new customers into the showrooms. On the other hand, negative comments posted on the web can have a particularly disadvantageous influence on purchasing decisions.

ROLE OF PRODUCT INFORMATION AND BRAND COMMITMENT

Due to the relatively low knowledge about cars, Chinese consumers gather the maximum possible information to eventually decide on a car brand and model. This happens through various information channels, such as car magazines, advertisements in various media, or sponsorship events. Apart from recommendations, auto shows figure among the most informative and credible means to learn about cars. Motor shows can be considered as a convenient way for consumers to come into “physical” contact with different models, an essential experience for them in order to constitute a vehicle “shopping list”. Car manufacturers have understood the importance of such vehicle exhibitions, and present their products on numerous regional auto shows across the mainland.

For car makers it will be essential, however, to receive any car knowledge obtained by promotional channels deepened in their distribution networks. Thus, individual vehicle presentations directly at the point of sales become a crucial element in brand marketing strategies. As research findings reveal, car dealers in China still have potential for improvement in presenting their

products to prospective customers, such as explaining vehicle exterior and interior, inviting potential buyers to sit in the car and proposing test drives.¹⁰ Impeccable dealer performances in this respect are extremely important as Chinese car buyers, on average, consider three brands and visit each dealership before making the purchase decision. Product attributes have high importance for their final choice.

In China, brand commitment, i.e. the strength of relationship between consumers and car brands, is still relatively weak compared to the more mature auto markets. More than half of car owners are not strongly attached to a certain brand, which makes them vulnerable to change brand (and dealership) when replacing their current vehicle.¹¹ Looking at the length of private car ownership in the Chinese market reveals that a significant share of motorists is likely to make a replacement purchase over the next years.¹² This has moved the notion of brand loyalty into the centre of considerations, and challenges car manufacturers as much as car dealers to meet the expectations in the market.

DEMAND FOR ADVANCED SERVICES

More than 95% of car buyers in China pay cash for their newly purchased vehicle. Car financing is tightly regulated by the government, and only several car manufacturers have obtained authorization to offer financing services to their customers. As results show, approximately 25% of new car buyers have access to finance offers, but only very few use them. Due to a lack of reliable information for credit checking, car manufacturers are careful in selecting eligible customers. On the other hand, customers do not yet perceive financing offers as important, and have not yet realized their benefit. Although low in absolute terms, finance offers tend to be most frequently chosen in Tier 1 cities

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(Beijing, Shanghai and Guangzhou) as well as in the premium vehicle segments. These cities are considered to be the most developed, while owners of premium cars are most experienced compared with the overall market. Under the assumption that the market will quickly evolve towards more maturity, it can be inferred that car financing may have the potential to penetrate the automotive market in the future.

Similarly, demand for more advanced after sales offers, such as extended warranty, is still low, but is expected to rise in importance as the market continues to develop. For car dealers it will be vital to anticipate the market developments, and propose additional service offers sufficiently early to secure a competitive advantage. In the long term, financing activities and after sales services are expected to generate a considerable part of a car dealer's earnings.

CHINA – MARKETS WITHIN A MARKET

Given its huge geography, and various market structures across the mainland, China cannot be seen as one single market. In fact, different levels of economic development and divergent states of market sophistication generate differences in consumer behaviours which have to be addressed by car makers, as well as also car dealers. Variations are particularly prominent with regard to

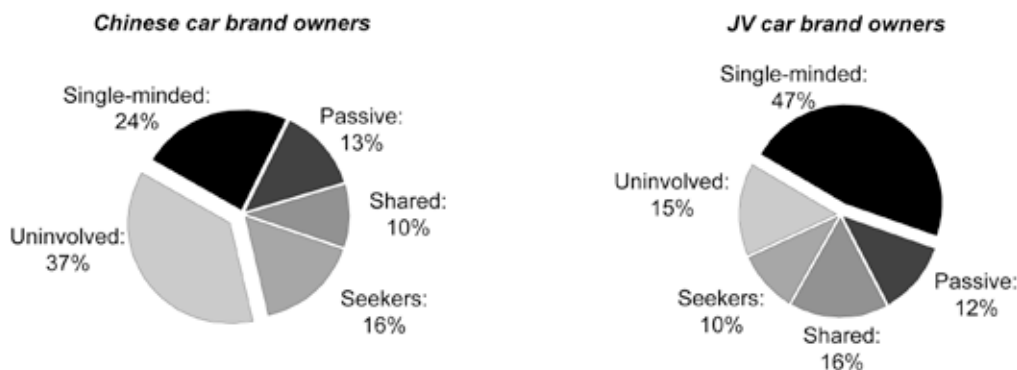
brand choice as well as between different tiers of cities which affect the customer-/dealer relationship:

- Chinese branded car owners turn out to be less brand committed than owners of foreign JV brands.
- Customers in Tier 1 cities appear to be more demanding than clients in lower tier cities.

CHINESE BRANDED CAR OWNERS VS. FOREIGN BRANDED CAR OWNERS

While owners of international JV branded cars select their vehicles on the basis of a comprehensive set of factors, buyers of Chinese originated cars choose their vehicles according to rational price considerations. They look above all for cheap or affordable cars. If price has a major impact on the purchase decision, and consumers rather focus on product functionalities, the notion of brand decreases. Indeed, more than one-third of Chinese car owners is proven to be indifferent towards brand choice, i.e. they do not really care which car brand they use. The share of such “uninvolved” consumers among Chinese car owners is 2.5 times higher than among owners of international JV brands. Furthermore, only one out of four Chinese car owners is strongly attached to a certain brand, compared with more or less every second owner of an international JV brand vehicle who has his preferred car brand (see figure 2).

**FIGURE 2
BRAND COMMITMENT OF CHINESE CAR OWNERS**



Single-minded: Strong attachment to one brand. Committed to one, may be uncommitted to others.

Passive: Committed, but less involved

Shared: Equally attracted to two ore more brands.

Seekers: Unhappy with current brand.

Uninvolved: Don't care which brand they use.

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In a context where cars are chosen on the basis of low prices, the service quality is likely to be underestimated by car dealers. It may be therefore little surprising that Chinese car owners are considerably less satisfied with the dealer performance than owners of cars from international car manufacturers. However, Chinese car owners, almost as importantly as JV brand car owners, do have expectations towards dealer services and want them to be met. The discrepancy between expectations and actual experiences in dealerships leaves no doubt that there is a need for Chinese branded car dealers to improve their service performances (see table 3).

As consumers focus mainly on price, deficits in dealer service quality have lead to considerably weak customer retention¹³ in Chinese branded car dealerships. This is not only an expression of low satisfaction with dealer performances but also signifies a reduced probability of re-purchase at the dealership. Furthermore, it has a negative impact on recommendations of the dealership to others (see table 4). Given the importance of positive word-of-mouth for bringing new customers into dealerships, it will be necessary that Chinese branded car dealerships improve their service quality in order to ensure sustained success in the future. As the market continues to mature, consumer demands

will rise, even in the lower vehicle segments where Chinese car manufacturers are particularly present. A considerable improvement of dealer performances will be indispensable for Chinese brands to succeed in the medium and high-end car segments where more intangible brand aspects as well as service excellence is more important, apart from functional product attributes and price.

Compared to Chinese brands, JV brands have managed to establish closer customer-/ dealer relationships. This is certainly due to the fact that product- and service quality as well as image perceptions are strongly driven by foreign brands. Satisfaction scores are significantly higher than those of Chinese brands, but nevertheless, results indicate that a relatively high proportion of customers may defect to another brand or dealership for the replacement of their car. This is partly due to the still relatively low brand commitment in the Chinese car market, but also indicates a huge potential for JV brand dealerships to improve their service quality to arrive at the level of their peers in the mature markets. As already mentioned above, consumer demands in the market are supposed to develop quickly, and the distribution network which anticipates these demands best will enjoy a competitive advantage.

TABLE 3
IMPORTANCE AND EXPECTATIONS TOWARDS DEALER PERFORMANCES

	Chinese car brand owners	JV car brand owners
Importance for expectations to be met (1-5)	3.32	3.69
Extremely and very satisfied	43%	65%

TABLE 4
LIKELIHOOD OF REPURCHASE AT DEALERSHIPS AND RECOMMENDATION

	Chinese car brand owners	JV car brand owners
Definite and probable repurchase	38%	58%
Definite and probable recommendation	55%	78%

TIER 1 CITIES VS. LOWER TIER CITIES

China's geography puts a huge challenge to car manufacturers for setting up distribution networks. With 9.6 million square kilometres, mainland China has the third largest extension of all countries in the world, behind Russia and Canada. Of its more than 1.3 billion inhabitants, around 570 million people are considered as urban population, with an estimated 20 million people moving from rural into urban areas every year. According to government estimations, the urbanization rate will reach 47% by 2010.¹⁴

Urban consumers live in 660 cities of different sizes:

- 11 mega cities with more than 4 million inhabitants
- 22 very large cities between 2 and 4 million inhabitants
- 141 cities between 1 and 2 million inhabitants
- 274 cities between 500,000 and 1 million inhabitants
- 172 cities between 200,000 and 500,000 inhabitants
- 40 cities below 200,000 inhabitants

It may not be surprising that huge structural and behavioural variances between these cities exist. Metropolitan areas can be categorized in different tiers, with Tier 1 cities Beijing, Shanghai, and Guangzhou as most developed agglomerations and economic centres in the mainland. Tier 2 and Tier 3 cities represent provincial capitals and major cities in the various provinces, and are important production locations and major retail markets. Accordingly, lower tier cities (Tier 4, 5, etc.) embody less well developed urban areas.

This impressive urban structure signifies a significant challenge for all car manufacturers in terms of the establishment of their distribution networks. In the context of the booming car market all vehicle makers have quickly enhanced their distribution towards the lower tier cities, while the number of overall sales outlets has remained most dense in the most developed Tier 1 cities. From the viewpoint of consumers, this means that car buyers have the biggest selection of dealerships in the big cities, which gives them the opportunity to choose between dealers of different brands but also between various outlets of one brand. This appears

to have consequences for the purchase behaviour.

Dealers in Tier 1 cities seem to offer a better performance to their customers than their peers in lower tier cities. Beside a wider range of products to select from, car buyers in Beijing, Shanghai, and Guangzhou disproportionately appreciate quality of advice of salesmen. Although recommendations from friends and acquaintances remain the top reason for choosing a particular sales outlet, almost 10% of customers in Tier 1 cities state the good advice from the dealer as main motivation to buy the car. The figure is twice and respectively three times as high as among car buyers in Tier 2 and Tier 3 cities (see table 5). This is an indication that intense competition helps dealers to improve their service quality. This conclusion is supported by the fact that car buyers in Tier 1 cities also tend to be more satisfied with the performance of the car dealers. At the same time, the increased competition and the greater market offer is supposed to make consumers more demanding. More than two thirds of car buyers in the most developed car markets on the mainland importantly state that car dealers meet their expectations.

In Tier 3 cities only half of car buyers feel that it is very or extremely important that dealers meet their expectations. As the brand- and product choice is smaller, customers in Tier 3 cities may be less sensitive to dealer performances, as they have to select a certain outlet for buying a certain make and model. Indeed, brand availability is the major reason to choose a certain dealership in Tier 3 cities. Car dealers in these lower tier cities may be tempted to rely on the appeal of the brand that they represent, but this bears an enormous risk in the medium and long term. As all car makers enhance their distribution networks towards lower tier cities a lack in customer service quality can quickly lead to a defection of customers in case that competition increases.

While dealer services are most developed in Tier 1 cities, and least advanced in Tier 3 cities, results show a rather mixed picture in Tier 2 cities. In many cases dealer performances and consumer behaviours arrive

TABLE 5
MAIN REASON FOR CAR PURCHASE AT THIS DEALERSHIP (BY TIER OF CITY)

Attributes	Tier 1	Tier 2	Tier 3
Recommendations from friends/ acquaintances	22%	32%	22%
Availability of preferred brands	15%	12%	31%
Good service quality	16%	17%	17%
Convenient location	18%	15%	10%
Low prices	11%	11%	12%
Good advice	9%	5%	3%
Wide range	6%	2%	2%
Close customer relations	3%	3%	3%

at the level of Beijing, Shanghai or Guangzhou, which lets us assume that lower tier cities follow the development path of Tier 1 cities. This means that also Tier 3 cities will evolve quickly with obvious consequences regarding consumer behaviour.

CONCLUSION

There is no doubt that China will maintain its dynamic development and remain one of the most important market places, if not become the key market for the automotive industry. The Chinese car market is influenced by various internal and external factors that give it a unique character amongst all car markets in the world.

Despite the structural specifics of its car market the “Middle Kingdom” passes through the various stages of market development which provides clear references to consumer behaviours. The enormous size of the mainland as well as the growth characteristics of the economy have lead to an uneven development path in the market, though, and created various patterns of consumer behaviours. Therefore, China cannot be considered as one single market place, but as different markets with various levels of sophistication and maturity.

This has major implications for an efficient customer service at car dealerships. The main challenge for

dealers is to understand the various facets of consumer needs and appropriately “deliver” according to individual customer expectations. As they act as the interface between car manufacturers and end-consumers, their service quality impacts brand perception and customer satisfaction to a large extent. Therefore, automotive dealers play an essential role for the purchase decision process of Chinese new car buyers.

The market investigation suggests two major directions to “accelerate” dealer performances and increase service excellence in the Chinese car market:

- Firstly, a high quality of basic dealer services must be ensured in all regions. In a country with a short history of private car ownership the rapid expansion of dealership networks is made difficult by the lack of experienced sales people. As the market growth is driven by first-time car buyers, inexperienced themselves, sales representatives with profound car knowledge and vehicle presentation - as well as negotiation skills - are a prerequisite for winning new clients.
- Secondly, dealers have to anticipate changes in consumer demands accurately, and should offer advanced customer service as early as possible. As the market matures and competition increases quickly, performing “ahead of the curve” not only helps to attract new clients but also to retain existing clients over time.

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Footnotes

1. MPV = Multi Purpose Vehicle, SUV = Sports Utility Vehicle
2. TNS China survey "Brand Health and Needs Segmentation Study" 2007
3. Economist Intelligence Unit (EIU)
4. Not more than 5-6% of all passenger vehicles sold are imported
5. CBU-Autostats
6. 3S = Sales, Service, Spare parts; 4S = Sales, Service, Spare parts, Surveys
7. www.tdctrade.com/report
8. TNS China survey "Brand Health and Needs Segmentation Study" 2007
9. Information is based on a market survey among n=1,041 recent new car owners. The study was carried out in eight different tier cities (Tier 1, Tier 2 and Tier 3) and covered motorists who have bought foreign branded or Chinese branded vehicles in three different car segments
10. TNS China survey "Dealer Performance Monitoring" 2007
11. TNS China survey "Brand Health and Needs Segmentation Study" 2007
12. According to experiences from other markets, car owners, on average, replace their vehicles after 6-7 years
13. Retention includes customer satisfaction with dealer performance, the probability of subsequent purchases from the dealer, the likelihood of recommending the dealer to others and the level of perception of a personal benefit by purchasing from the dealer
14. National Statistics Bureau, www.gov.cn

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