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Dr. Jan Burgard

Executive Partner; Co-Founder at Berylls Strategy Advisors

THE CHINESE USED CAR MARKET – “Potential but not without challenges”

This article is part of our “Quo Vadis, China?” series. Our full study can be downloaded here.

+++ Management Briefing +++

- In 2019, the sales volume of new cars in China was 25.77 million, a year-on-year decrease of 8.2%.
- In the same year, the accumulated trading volume of used cars was 14.92 million, a year-on-year increase of 7.96%.
- By comparison, in 2019 the sales volume of new cars and used cars in the US was 17 million and 40 million respectively, equivalent to 2.35 used cars sold for every new car, making used cars a major profitability contributor for every new car dealer
- This shows that compared to Western markets, China's used car market is still in its infancy, and that there is still significant room for future growth.
- However, there are still several factors impeding the maturation of the Chinese used car market, including policy inconsistencies, a lack of standards and trust, limited scale, low e-commerce penetration, dated used car offerings and stark regional differences.
- In order to grow the used car business in their dealer networks, OEMs should leverage their brand and provide certified pre-owned cars scheme to build customer trust. Dealers should consolidate their used car operations and consider going multi-brand from the start.

BERYLLS STRATEGY ADVISORS GmbH

CONTACT
Dr. Jan Burgard
Maximilianstraße 34
80539 Munich

T +49 89 710 410 40-0
jan.burgard@berylls.com

www.berylls.com
info@berylls.com

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China's used car market – General overview and key success factors

During the COVID-19 outbreak, the Chinese government introduced a series of measures to stimulate the sale of used cars. The Ministry of Finance and the State Administration of Taxation, for example, announced on April 9 that the VAT-rate for used car purchases would be reduced to 0.5% until year end, from previously 3%. Also, the central government has issued a number of policies to simplify used car transactions and registrations.

But will these policies usher the Chinese used cars market into a new era of maturing and growth?

The big picture

The Chinese used car market is quite young, historically most of the trade was done directly between buyers and sellers. It was not until 1998 when the first used car agents and brokers appeared. In the following years, further market players were established like used car market places, used car auctions, and e-commerce platforms. And in 2005 the Chinese government started to introduce policies regulating the used car market.

Between 2011 and 2015 trade volume grew by 8.4% annually from 6.8 million to 9.4 million. From 2015 onwards, growth in trade volume accelerated to 12.2% annually and reached almost 15 million units in 2019.

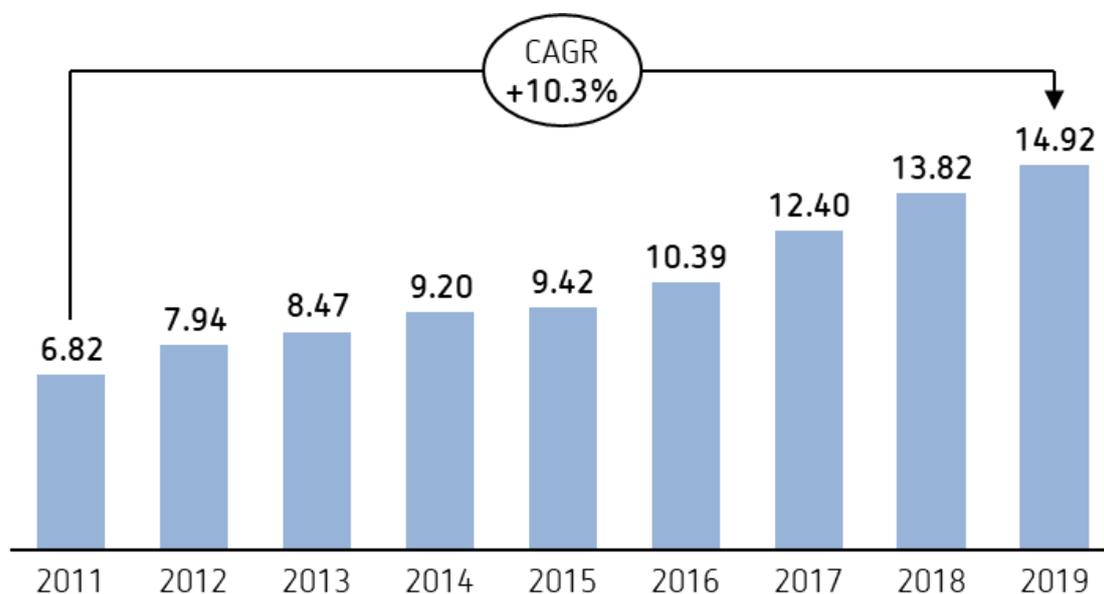


Figure 1 Used car trade volume per year [mn units]

During this period, used car e-commerce platforms emerged and continued to develop rapidly, attracting large amounts of financial investment.

Yet, compared to mature markets such as the USA, China is still in its infancy. The trading ratio of used cars to new cars was only 0.58:1 in 2019. The USA had a ratio of 2.35:1 in the same period indicating significant room for future growth in China.

The key challenges confronting the Chinese used car market today

- **Asymmetry of central government policy legislation and local government implementation**
Although the Chinese central government has issued a series of policies to develop the used car market, local restrictions, e.g. regarding cross-city circulation of used cars, have yet to be fully eliminated.
- **“Lemon problems”, missing evaluation standards and lack of trust**
Weak valuation standards and pricing intransparency foster intense price competition in the used car market and damage the reputation of used cars in general. They act as the key deterrent for potential buyers. This lack of trust in turn further weakens average pricing.
- **Used car dealers have limited scale**
70% of the used car dealers in China record less than 3 million RMB annual revenues. 72% of all used car dealers have an average monthly trading volume of less than 15 vehicles. This small scale leads to unstable businesses.
- **E-commerce penetration remains very low**
Online trading only accounts for 3% of the total used car market. By contrast, in mature markets, such as Germany, online sales account for as much 90% of used car sales.
- **Regional differences are in-, not decreasing**
In recent years, tier-2 cities have taken the largest share in the used car market, and transactions in the lower tiered regions have steadily increased. Meanwhile, trading volume of used cars in Beijing and Shanghai is relatively low and even declining.

Why bother?

China’s used car market is today rife with risk. Not surprisingly, many OEMs have so far held back and let others get their fingers burned. However, as growth in new car sales continues to slow down, OEMs need to look for new means to strengthen their China businesses. Together with their branded networks they must diversify their Chinese operating model. This must include a comprehensive used car strategy to grow the dealers’ revenue pool and to reinforce their joint service, parts and financing business. A liquid and professional used car business will positively impact new car sales through attractive residuals, allowing shorter ownership cycles.

From our perspective, only a tight cooperation between OEMs and retailers can make the used cars market work, with OEMs in the leading role. Together OEMs and retailers can create a win-win situation and establish a complete ecosystem and fend off new players.

How to master the challenges?

BERYLLS STRATEGY ADVISORS GmbH

CONTACT
Dr. Jan Burgard
Maximilianstraße 34
80539 Munich

T +49 89 710 410 40-0
jan.burgard@berylls.com

www.berylls.com
info@berylls.com

In Berylls' opinion, OEMs should actively drive the maturation of the Chinese used car market. Together with their retailers they should play a leading role in addressing the current lack of scale and price transparency.

- **Leverage brand reputation, OEM certification, extended warranty and service contracts to build trust in used car quality**
The introduction of OEM certified pre-owned cars as well as extended warranties or service contracts for used cars will be crucial tools to ease buyers' concerns. This is especially important for Western and Japanese brands, whose ability to operate profitable used car businesses hinges on charging a premium for brand-certification. This may require upfront marketing investments.
- **Scale up and pool**
An OEM-consolidated marketplace, that provides full transparency on all available vehicles, has the potential to become a go-to place for customers looking to buy a used car. It also makes the best use of all available resources as it can pool resources from numerous dealers and outside investors.
- **Go multiple-channel**
Besides selling used cars through franchised OEM channels, other channels can be used too, both physically and digitally. OEMs may even consider extending their certification schemes to qualified third parties, such as agents or automalls or cooperating with used car platforms to take advantage of the latter's customer base and reach.
- **Go multi-brand**
From a retailer and investor perspective, it makes sense to consolidate all used cars into a single used car center. This applies equally to cars of different brands. OEMs should themselves embrace multi-brand approaches to used car retail. This matches developments in Western markets where customers already accept used car certification from one brand for cars of another.
- **Include captive used car-specific financial service offerings from the start**
OEMs need to consider offering comprehensive and specific financial services for different used car age segments from the start. This lowers the hurdle of high purchasing costs.
- **Build differentiated offering to cater to different segments and geographies**
One way to satisfy the need for low prices is the introduction of differently graded certificates depending on the vehicle age (with lower pricing with age). Similarly, age dependent offerings are needed in aftersales where specific parts and services can target used cars depending on their age.
- **Tailor used car retail formats to market size and nature**
Large outlet stores which provide competitive pricing could be deployed in smaller cities focusing on functionality without high CI standards. For tier-1 & 2 cities, OEMs should ensure that late model used cars are displayed in used car centers with higher CI standards.

- **Used car specialization within retail**
Dealers should deploy specific personnel for used cars and make used car sales a key part of their performance metrics.
- **Widespread promotion and marketing**
Used cars too should be heavily promoted. OEMs and retailers should deploy the very same marketing instruments, including promotion of used cars on Single's Day, local autoshows – and fully utilise the digital marketing toolbox.

The time to implement these measures is right now. Each OEM's Chinese recovery program should include such measures designed to tap into China's emerging used car market. If the Covid19-induced economic crisis has shown one thing, it is the Chinese economy's resilience and Chinese customers' ability to adapt. For years now, China has become a proving ground of new business models. Get it right, and customers will come.

Outlook – Weathering the changes ahead

The Chinese automotive market has changed substantially in the recent years. Simple growth strategies will no longer work in an environment, where the new winners will be determined based on who can best spot emerging market potential. Weathering the change requires all facets of automotive retail to work seamlessly, including used car sales to drive trade-ins and to boost the aftersales business. Read our full study on China to find out more about a country you thought you knew.

Berylls Strategy Advisors is a top management consulting firm specialized in the automotive industry, with offices in Munich and Berlin, in China, in Great Britain, in South Korea, in Switzerland and in the USA. Its strategy advisors and associated expert network collaborate with automotive manufacturers, automotive suppliers, engineering services providers, outfitters, and investors to find answers to the automotive industry's key challenges. The main focus is on innovation strategies and growth strategies, support for mergers & acquisitions, organizational development and transformation, and profit improvement measures across the entire value chain.

In addition, together with our clients, experts at Berylls Digital Ventures develop solutions for digitizing and transforming the business models of OEMs, suppliers, and engineering services providers. Longstanding experience, well-founded knowledge, innovative solutions, as well as an entrepreneurial mindset distinguish Berylls Equity Partners provides automotive industry companies with know-how and entrepreneurial capital. Strong anchor investors provide financial support for companies at all stages of the value chain in special situations. Berylls's consulting teams are characterized by many years of experience, profound knowledge as well as innovative solution competence and entrepreneurial thinking. Through partnerships with experts, Berylls can draw on in-depth technology expertise, a comprehensive understanding of the market, and powerful networks in order to develop workable solutions.

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