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When it rains, it pours.
New kids on the block threatening the automotive status quo in China

This is the start of our new mini-series on what we call the "new fronts for the establishment". This week, we provide an overview of the new competition. Continue reading in the upcoming weeks for more insights.

The end of the establishment?

The Chinese automotive industry is quite young, with the first passenger car joint venture (SAIC Volkswagen) only being launched in 1985. Over the years, a multitude of Western players as well as Japanese and Korean players have entered the market through JVs along with the emergences of local players such as Geely, Chang'An, Chery etc.

This organically grown market has recently experienced a spike in new entrants. A new generation of players that threaten the established OEM market in China.

From our perspective, there are four main clusters of new entrants:

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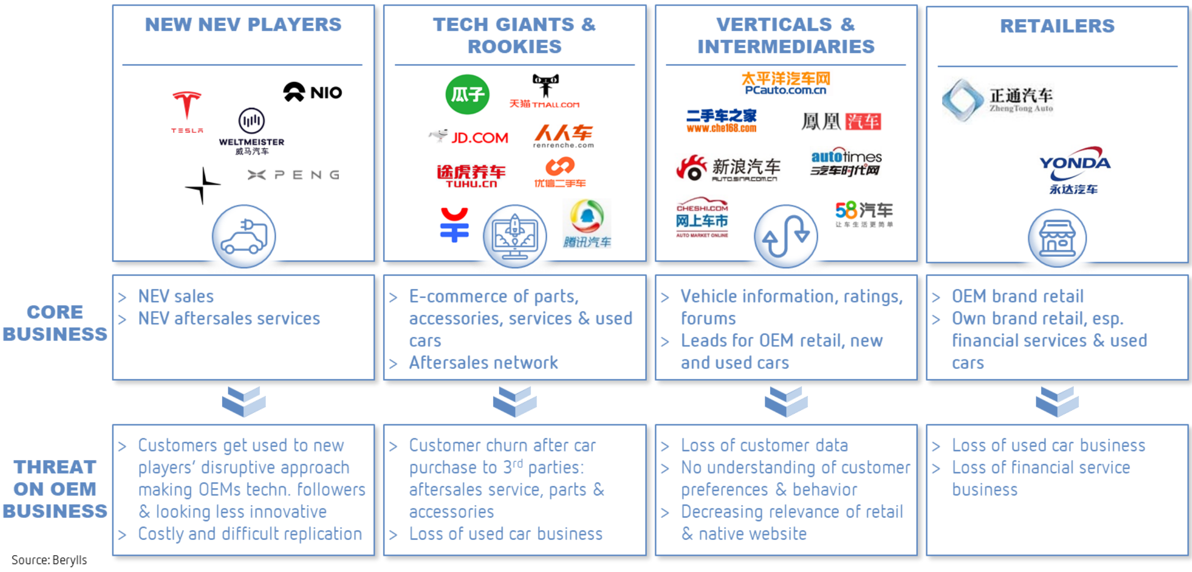
1. New NEV players such as Tesla and NIO
2. Tech giants and rookies such as Tmall and Guazi
3. Verticals and intermediaries such as Autohome, PCauto
4. Retail investors such as Yongda and Zhengtong



Four main clusters of new entrants (including exemplary competitors)

In addition, mobility service providers are turning OEMs into hardware suppliers. The dominance and ubiquity of shared mobility service providers such as Didi and Meituan in China poses a further challenge to OEMs. OEM owned mobility services, e.g. ShareNow, Bolt, WeShare, have failed to establish themselves in China. As the consumption of shared mobility continues to rise, OEMs run the danger of losing touch with the customer and becoming B2B hardware providers.
This may not necessarily be a major threat to OEMs as it supports vehicle sales, but it may pose a threat to top line as the mobility service operators dictate the configuration of the vehicle and may forgo high margin add-ons such as infotainment systems.

We are fully aware that there are various other players besides the mentioned clusters. Some of them come from completely unrelated industry segments, such as the Evergrande Group, a conglomerate built on real estate, healthcare and tourism, who acquired NEVS (which came out of insolvency of SAAB) and aims to engage in NEVs. Since these players are numerous and diverse yet engage in one of our mentioned clusters, we will focus on our 4 clusters in this paper.

What do the main entrants offer? What makes them special? How do they pose a threat to traditional OEMs? Berylls has produced this paper in an effort to answer these questions.

1. A new wave of OEMs: NEV players

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Since 2010, NEVs have gradually gained traction in China thanks to generous government subsidies. Not only international players such as Tesla, but also local Chinese NEV startups have appeared such as NIO, Xpeng, Lixiang, Weltmeister, Hozon, Aiways etc. with NIO being the best known and highest selling amongst them: from January to May of 2020, NIO sold 10,324 vehicles and had the leading position among NEV startups. Like Tesla's sales model, NIO also adopted the online & offline direct sales model using showrooms in high-footfall areas and separated sales from aftersales. This is manifested through the physical separation of vehicle showrooms and service centers, which are either operated by NIO itself or in cooperation with ISPs (Independent Service Provider). The sales customer journey is focused on urban showrooms called NIO Houses or Spaces. It has brought a few new things to the table: NIO House & Space do not only offer product experiences, but also owners' clubrooms to boost customer retention. NIO's sales personnel are called "ambassadors" and act as the primary interface during the purchase journey. Customers are registered in NIO's data base and receive unique and universal IDs to ensure seamless customer data access. Through personalized WeChat groups, NIO stays connected with its customers and provides personalized offerings and services after purchase. The advantages over traditional OEMs: price consistency and transparency, strong customer centricity, uniform experience, and customers' trust through the elimination of the retail "middleman". Furthermore, direct, and continuous interaction with customers ensure holistic customer data gathering and management.

Although some of these NEV startups were laughed at as "making cars with PowerPoint" as some of them were notoriously known to use PowerPoint presentations to attract investors without any physical vehicle concept or prototype, they are now a force to be reckoned with. Their approach on sales, brand experience, aftersales and convenience is highly influential.

Strategies for traditional OEMs:

- Leverage existing strengths: strong retail, marketing, physical presence etc. to improve awareness and retention
- Improve retail interface and focus more on the brand experience aspect along with customer centric and value adding (digital) service offerings in sales and aftersales
- Consider on-boarding new partners and specialized players for retail network operations to improve customer experience and professionalize food & beverage operations, esp. with regards to operation of brand experience stores

2. A farewell to OEM e-commerce: Tech giants & rookies

E-commerce and digital sales are the new normal in China, which has only been accelerated through the COVID-19 crisis. In 2018, the number of internet users in China exceeded 800 million, and the number of online shopping users reached 610 million (source: CNNIC). In the same year, purchases made on e-commerce platforms comprised 21.9% of the total household expenditure. Among which tech giants, Taobao & Tmall platforms (both belong

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to the Alibaba group) occupied the first place with 45.4% of consumption share, and JD.com ranked as the second with 17% share (source: AURORA).

In light of this development, various types of players have emerged. E-commerce giants such as Tmall and JD.com, competing with OEMs and traditional retail on auto parts, accessories etc. OEMs have quickly adopted to this phenomenon and chose to have their web presence on the large e-commerce platforms instead of native websites; so, they use these tech giants' platforms.

In the shadows of these internet giants, a number of very specialized players have emerged competing with OEMs in certain niches. In aftersales, Tuhu has aggregated a vast amount number of ISPs (independent service providers) into its platform, allowing online intelligent scheduling of maintenance and repair appointments. Over 13,000 ISPs have now been registered and 18% of the entire car park in China is serviced by Tuhu. In addition, Tuhu runs an e-commerce platform for parts, accessories and has over 1,000 Tuhu branded garages. In used cars, Guazi, Youxin and Renrenche offer a complete ecosystem for used cars. The entire sales journey is implemented online from car searching, selection, assessment and valuation, financial services, transaction and aftersales etc. These players offer a one-stop shop service for buyers and sellers.

These players are actually more threatening than Baidu, Alibaba or Tencent, taking away OEMs' and retailers' entire business sectors along with loss of customer data. Some of these players have large financial backing, such as Guazi who is financed by Sequoia and Softbank among others with a total funding of USD 3.6 bn., Renrenche with financing from Tencent, Goldman Sachs, Didi among others and a total funding of USD 760 mn. and Tuhu, who count Tencent, Sequoia and CICC among its investors with more than USD 870 mn. of funding (source: Crunchbase).
Strategies for traditional OEMs:

- Establish OEM branded eco-systems, which affect customer retention and potential customer development
- Leverage brand strength, consolidate resources, use an O2O approach and professionalize used car sales to quickly build a used car ecosystem and provide competition to new players
- Consider exclusive areas within eco-system of 3rd party players, e.g. OEM certified pre-owned cars within Guazi's platform to benefit from its customer reach, consolidate resources and reduce expenditures of developing an OEM's own used cars ecosystem (for more details please refer to our used cars paper)

3. Influx of a new type of players: Verticals & intermediaries

Websites such as Autohome, bitauto, iFeng auto, Auto Sina, PCauto, etc., have attracted a large number of users by providing vehicle information and comparison, discussion forums, vehicle ratings, vehicle recommendations, tips and tricks, entertainment and a more

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customer centric vehicle purchase. While these websites are a good source of independent information and consumer information, they have turned into something OEMs should fear.

Today, these verticals offer a one-stop shop for customers who can select vehicles, find extensive vehicle data and pricing information and search and book test drives at 4S dealers. Customers can also negotiate prices, find financial offerings, and offer trade-ins. Furthermore, they have improved their vehicle presentation from static pictures to AR/VR. Thus, these verticals have become a complete ecosystem providing a one-stop shop from their websites directly to the 4S dealer, passing over the OEM completely. With a total of 430 million active users, 13.85 million daily unique visitors to its App and more than 44.64 million daily active users overall, Autohome is currently the most visited automobile website in the world (source: Autohome, as of June 29, 2020). In fact, verticals such as Autohome are holding all customer data and making OEM websites complete obsolete. Some of these players have large financial backing, such as Autohome who had its IPO in 2013 at NYSE and was acquired by Ping An (the 3rd largest insurance company globally) in 2016, Bitauto which is financed by Tencent, JD.com and Baidu among others with a funding of USD 1 bn.

The new challengers have come a long way. They started as providers of information for customers, then turned into lead generators for dealers and advertising service providers. Now they have become transaction-supporting intermediaries. Dealers now do not just market their inventories but can provide their services directly to customers (including test drives and financing offers). The spectrum of functionalities of verticals & intermediaries is way too broad for OEMs to mimic, making substitutions nearly impossible. A multi-brand setup, which has not worked in the physical but seems to work online, has quite a few advantages. The most important one for Chinese customers is comparison between different brands.

The big difference between this group of players and the tech giants and specialized rookies is that these players do not threaten the OEM's revenues at all. On the contrary, they help retail to achieve more sales. And herein lies the problem: these verticals and intermediaries hold all customer data in their hands. That means that OEMs' connection with their customers will erode over time as they will have no information over customer preferences and behavior making a pro-active customer engagement nearly impossible.

Strategies for traditional OEMs:

- Cooperate with players like Autohome on the early phases when customers are on the look-out for different brands but bring them into the OEM native channel as soon as customers are considering a specific brand/model
- Partnering with these players through OEM exclusive area within their ecosystem, e.g. a brand specific area within Autohome where OEM grants special offers; herefore, the OEM receives all relevant customer data

4. Partners turning into competitors: Retail investors

In 2019, in terms of the profit situation of retail investors, 42% of all dealers were in the state of loss, only 31% were profitable, and 27% just achieved break even (source: Auto Business Review). Among the profitable dealers, only 10% of them have experienced a net increase compared to the previous year. This development stems primarily from lowering profitability from new car sales. Thus, some of them have engaged in businesses beyond new car sales and aftersales to open additional revenue streams. For example: Yongda, the fourth largest dealer group in China (in terms of revenue, source: CADA) has stepped into the used car space, selling used cars under their own brand and dealers such as Zhengtong (the 13th largest dealer group) have begun to provide own financial service offerings. Dealer groups have multiple advantages through a multi-brand setup and extensive physical networks. Furthermore, dealer groups can provide competitive offerings, e.g. used cars at lower prices. Instead of dealers being mere traders and vessels for other entities to generate revenue, they directly engage in these business fields leveraging their size and network. They show clear aspirations to develop their own B2C vehicle sales brands and bind their customers to their own brand rather than to that of the OEM.

Strategies for traditional OEMs:

- OEMs should be careful not to lose revenue to these developments, e.g. in financial services; OEMs should also beware of brand dilution if customers cannot distinguish between genuine OEM offerings and retailer offerings
- In used cars, OEMs should cooperate with dealer groups to create a win-win situation (for more details please refer to our used cars paper)
- Financial services offering of retailers can be limited through incentive schemes, e.g. OEMs can use number of financial service contracts sold as a binding target and change the incentive for each financial service contract sold
- Incentive system should be generally adapted, e.g. incentives for financial services could be lowered while that of customer satisfaction and re-purchase/customer re-activation could be increased (which goes hand in hand with our very first point)

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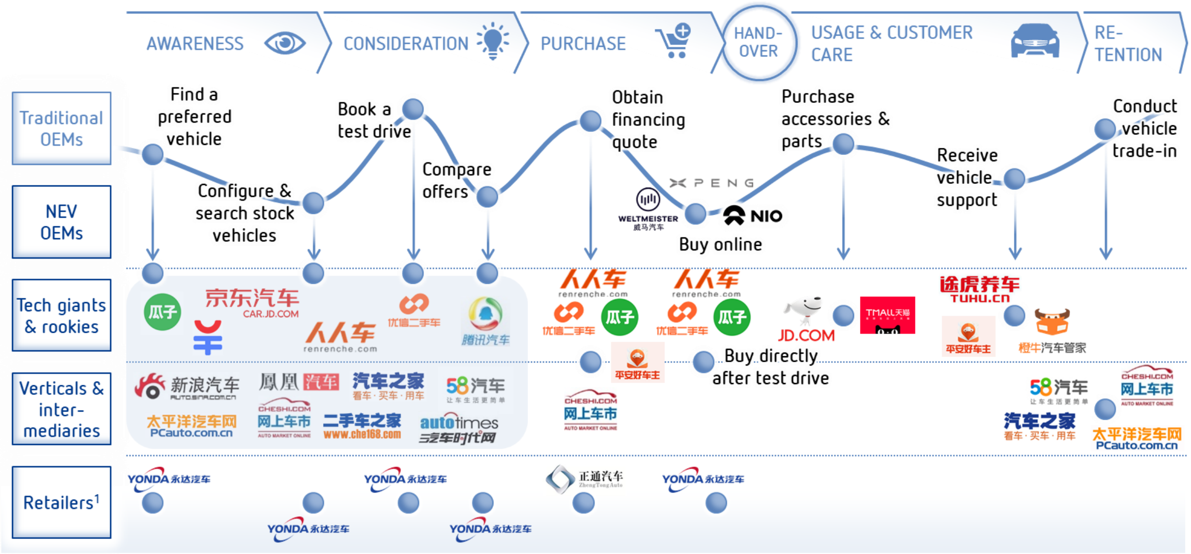

1 Yongda's used car program under its own brand; Zhentong provides its own financial services
Source: Berylls

Competition for key touchpoints across the entire customer journey is heating up (exemplary competitor landscape)

The last call for OEMs?

Amid the crisis, OEMs around the globe are looking full of hope to China, the first-to-recover-market. It is therefore elemental that OEMs react decisively and swiftly, either countering or collaborating where necessary. It is obvious that these new competitors are quick to verticalize and reach scale – while seemingly small at the current stage, they could expand very quick and seriously threaten established OEMs.

This is the start of our new mini-series on what we call the "new fronts for the establishment". Stay tuned in the upcoming weeks for further insights. Up next: New NEV players and how they will change our views on customer centricity.

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