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This article continues our mini-series on what we call the "new fronts for the establishment". This week, we provide a detailed explanation of another new competitive cluster – The Retailer

Retail investors and traditional OEMs – the perfect marriage?

Let us take you on a thought journey: Imagine you want to buy a new car. After doing some research and comparison of various brands and models that might be of interest, you decide on the brand and model you would most likely want to purchase. Say, you want to purchase a Mercedes A-Class. You want to get further information at a Mercedes-Benz dealer, and take a test drive. Thus, you search for the closest dealer and march into the showroom.
Did you know that with the traditional OEMs, you often enter a dealership that belongs to a large dealer group representing the brand in your town?
Ideally, you should neither know nor notice to which of the many dealer groups the outlet belongs. The experience should be the same at each dealer and fully represent the make's values and goals. So, at best, every dealership follows the same guidelines for corporate identity/design and customer service as agreed upon with the brand they represent – just like with McDonald's. No matter where you are, each McDonald's has the same general interior design and the burgers taste identical due to using the same ingrediencies and cooking processes.

This practice makes perfect sense since, it lays the foundation for a lucrative business for both parties. From an OEM's point of view, it is ideal if the customers do not notice that the dealership they are entering belongs to a dealer group. In return, the OEM authorizes dealers to act on their behalf and through this, hands out a seal of approval which gives the customer the signal that this dealer and his aftersales are qualified.

But the relationship between the OEM and retailer can be strained by conflicts of interests.

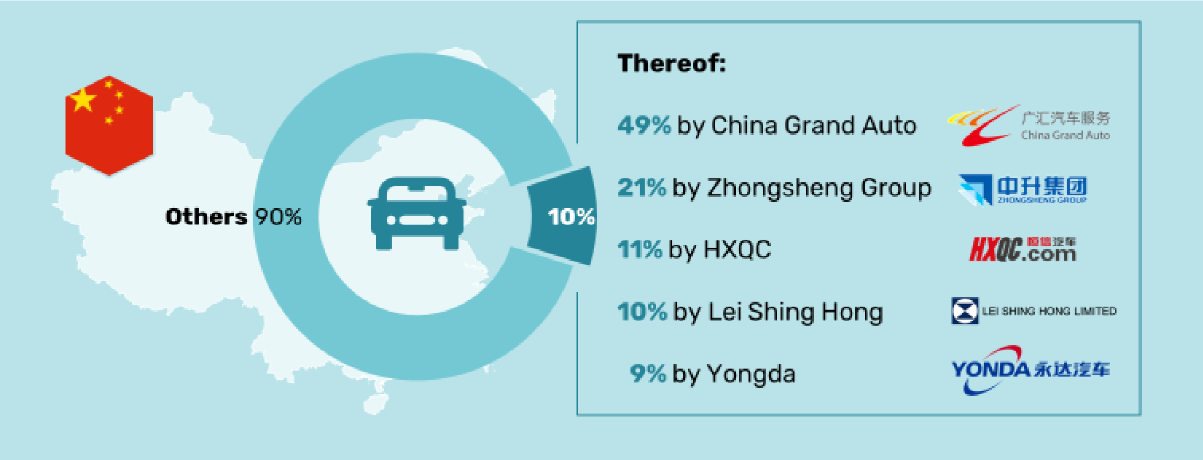
Until death do you part

Now imagine a different scenario where you want to buy a car and you first compare dealerships in your vicinity before thinking about what brand or model to choose. Imagine the dealers' brand is so strong because of its unique customer service and experience that it would not matter to you WHAT you buy but WHERE and from WHOM you buy it.

Sounds all too unrealistic? Not so in other consumer industries with strong retail brands. So maybe time to discuss also in automotive.
There are two main business models for OEMs selling their cars to the customer: retail them directly via their homepage or in their own sales rooms (the most prominent examples for this are Tesla and NIO) or conclude agreements with a dealer (group) and wholesale the cars to the dealers, who in turn retail them through their showrooms or online to customers.

Amongst the largest dealer groups are China Grand Auto, Zhongsheng Group, Lei Shing Hong, Yongda and HXQC. These five alone achieved combined sales of 2.54 mn cars in 2019, with over 45 brands, reaching a market share in China of almost 10%.

IN 2019, OVER 25 MN. CARS HAVE BEEN SOLD IN CHINA



Source: BeryllsStrategyAdvisors.

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In China, the retail operating profit margins are between 1-3%, which is on the higher end, compared to other dealers worldwide. Their business model usually relies on three main pillars: while their core business is new car sales, they also generate revenues with aftersales & financial services. Furthermore, they invest in and leverage related businesses, like car beautification & modification services, insurances brokerage, administrative license plate services, car rentals or, like Zhengtong does, offering own financial services.

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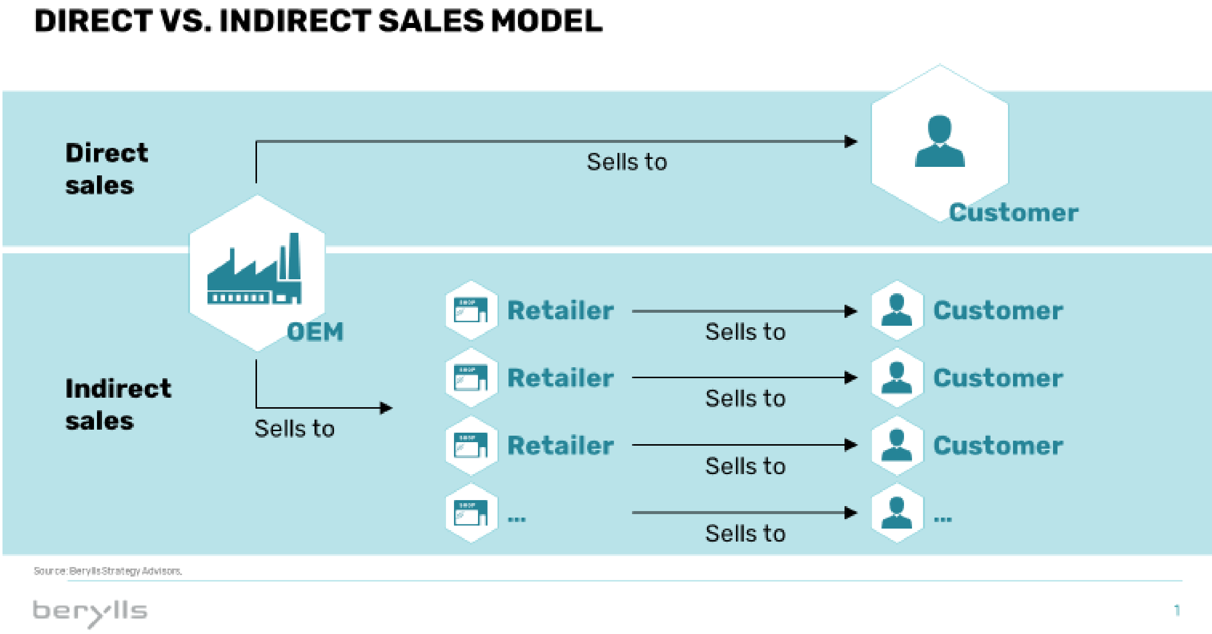
In the past decade, collaboration between dealers and OEMs has increasingly intensified. Based on the automotive success story in China both parties took much pleasure in working together. With growing trust, contractual obligations have also evolved. One of the most significant developments took place around notice periods for contracts between dealers and OEMs. In the past, both parties could cancel contracts monthly. Today it is common that both parties can step out of the contract once a year, otherwise the cooperation is extended for another year.

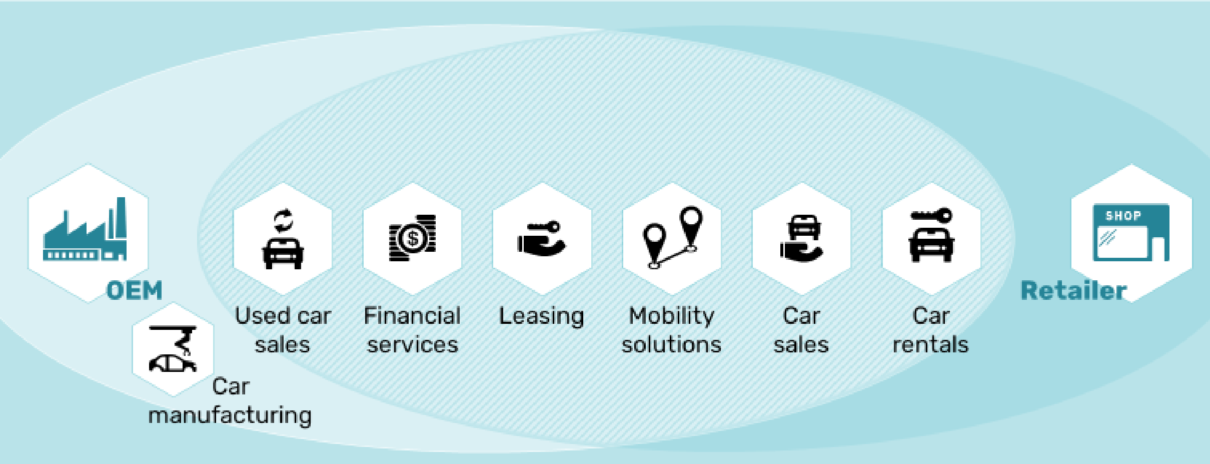


So far it all sounds good, what could threaten this win-win status quo?

Greed.

Aside from new vehicles, OEMs also provide leasing packages, financial services, some used cars and many mobility solutions like car rentals. Customers can get informed about these services and offers at any dealership and are able to purchase them there.
But with more experience in the business and more customer interaction and knowledge, big dealer groups are increasingly taking things into their own hands and are now more than ever offering their own leasing packages, other financial services, used car sales and so on. Furthermore, they got tailwinds from a legal perspective: The Ministry of Commerce of the People's Republic of China (MOFCOM) regulates the framework conditions and the structure of such contracts, and in 2017 MOFCOM issued an update on "Vehicle sales management methods", which massively strengthened the position of dealers. One big restriction, that was loosened by MOFCOM, was sales and aftersales of other brands within an authorized dealership. While this was not allowed before, much in favor of the OEM seeking exclusivity, dealers can now operate multi-brand dealerships.

WITH THE EXCEPTION OF CAR MANUFACTURING, OEMS AND RETAILERS NOW PROVIDE THE SAME OFFERS & SERVICES



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Lots of strings attached

OEMs with a large retail network and no direct sales logically rely on the cooperation with dealer groups. Also, with dealers acting as a middleman on the customer front and almost exclusively communicating with the customers, the OEM is cut off from the customer and does not get access to valuable customer data.
But dependency also exists in the other direction: The OEM can start re-structuring its retail landscape, focusing on online sales with own showrooms in the cities – and eventually moving fully to direct sales. Without the authorization of the brand, a dealer group cannot legally sell a make's brand-new car and thus any product and service dependent on new car sales will not be sold and little money can be earned.

Time to bring back the romance

Knowing that both parties are naturally focused on maximizing their own profits, harmonious cooperation must be encouraged for a successful and sustainable business. OEMs can already control a great deal through margin schemes and incentive programs. But with increasing competition and sales pressure, often these approaches are insufficient and outdated, therefore new approaches need to be taken into consideration and evaluated. If retailers rise to provide direct competition to the OEM's services, they are apparently dissatisfied with their current returns. Some further tweaking of the margin system here and there to get rid of this inherent conflict of interest between OEMs and retailer may appear highly intuitive but will not solve this fundamental problem.

The hyper competitive Chinese market environment, with or without the impact of COVID, demands from all market participants intelligent ways to exploit market potential instead of seeking a panacea in blind expansion. Hence, this could be a perfect opportunity for OEMs and dealers to explore new ways to collaborate 'in front of the customer'.

Win-win-win. It is possible

Interestingly, the new competitors we described in previous articles, may also come very well into play here, esp. with regards to digitalization and online-to-offline integration. New players, such as verticals like Autohome and Bitauto can function as interface between OEMs and dealers to enable shared and mutually enhanced data. For instance, lead quantity and quality could be increased through a common aggregator in the middle. Customer data and insights are also gathered by new digital media platforms these days. Through live-streaming events they amass vast feedbacks on colors, design, features, etc. OEM-orchestrated usage that data can help dealers to create truly targeted customer approaches and thus create higher conversion.

Bottom-line, the opportunities are plenty for both OEMs and retailers to ring in a new era of their partnership. Based on the usage of maturing digital technology and shared data they can create higher conversion, better loyalty, better supply, and in the end lower discounts, and happier customers. Win-win-win.
With our deep insights into the dealer group landscape and business handling tools and manners, we advise OEMs and help them explore the most suited business model for them.

And with this we close our mini-series on what we call the "new fronts for the establishment". Continue reading in the upcoming weeks for more insights. Up next, we tackle the probably most exciting myth of a country you thought you knew: The Chinese customer

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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.
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