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With this article we kick-off the final topic cluster of our "Quo Vadis, China"-insights which will accompany us until the end of this year. And we have saved the most exciting subject until the end: The Chinese Customer. We begin today with some regional profiling as we see new battlegrounds for new customers opening in the Chinese "countryside". Stay tuned in the following weeks to read more about a target group you thought you know.

How surprising: there is no SINGLE Chinese auto customer

It is a popular fallacy when researchers, consultants and other experts think they can simply set out and create an understanding of the Chinese auto customer. Yet, this is far from true!

Based on differences in cities' economic development and consumption environment, consumers naturally have different preferences and requirements for cars. Just like in Europe, car makers also found individual and local approaches for the different markets and customer segments in China. It is time to take a deeper look at the Chinese customer. BUT DIFFERENT this time.

Yet, this is not a dull attempt to remind western OEMs about lack of attention beyond top-tier cities in China. In fact, sales numbers prove that especially German premium OEMs are deploying successful go-to-market approaches across the entire country. There are latent risks elsewhere.

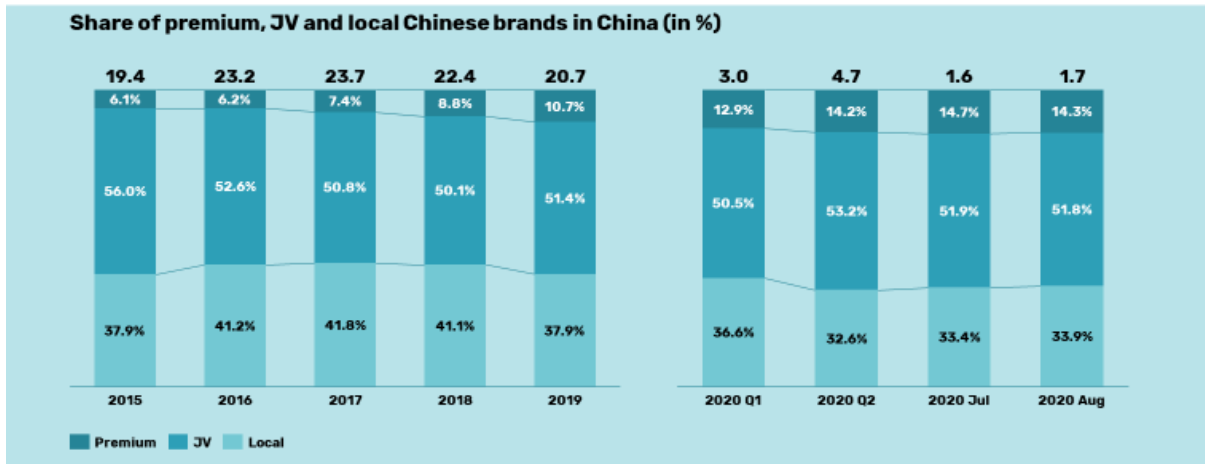
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PREMIUM* IS MORE POPULAR THAN EVER, EVEN DURING THE COVID-19 PANDEMIC



The top criterion: Wallet size

Let us start with the most obvious approach: Purchasing power.

The National Information Center divides the most relevant 341 cities into 6 tiers, however, we found that the 6 tiers can be further simplified into three market levels:

- cities in tier 1 (e.g. Beijing & Shanghai) belong to the 1st market level
- cities in tier 2 and tier 3 belong to the 2nd market level
- and the remaining tier 4-6 cities are in the 3rd market level

The categorization is done according to their sales volume of passenger cars. Importantly, this classification also reflects differences in customer preferences and purchase behavior.

The 1st market level

Cities such as Beijing, Shanghai, Guangzhou, and Shenzhen rank highest in purchasing power and therefore also in vehicle sales & car park. Growth rates for future demand however are expected to slow down, settling at a stable single-digit growth level.

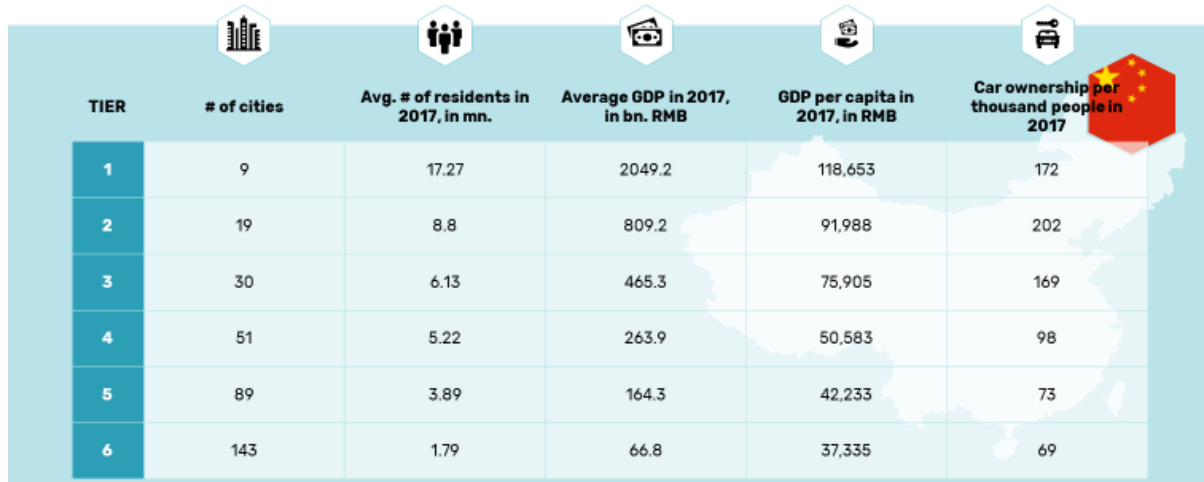
So how do customers in these cities make their purchase decision? Our recent proprietary survey on "CUSTOMER BEHAVIOR IN THE FACE OF COVID-19" shows a strong preference for premium brands as 42% of volume-brand car owners plan to buy a premium vehicle next, while only 17% of premium owners consider downgrading to volume.

For many customers in this 1st market level, brand image and the customer experience are the more critical purchasing criteria for customers. Premium and luxury brands, which are often JV brands, generally perform well in these cities.

And these cities are also the ones with highest NEV acceptance. A study by Daily Economic News

and Tencent Automobile shows that of the 72.9% consumers would buy a new car, 40% confirmed that they would buy an NEV even if purchase restrictions for gasoline vehicle were lifted.

CHINESE CITY TIER CLASSIFICATION



TIER	# of cities	Avg. # of residents in 2017, in mn.	Average GDP in 2017, in bn. RMB	GDP per capita in 2017, in RMB	Car ownership per thousand people in 2017
1	9	17.27	2049.2	118,653	172
2	19	8.8	809.2	91,988	202
3	30	6.13	465.3	75,905	169
4	51	5.22	263.9	50,583	98
5	89	3.89	164.3	42,233	73
6	143	1.79	66.8	37,335	69

Source: State Information Center, Berylls Strategy Advisors

The 2nd market level (cities in tier 2 and tier 3)

Unfortunately, there are hardly any scientific and quantitative studies on these cities due to the high numbers and geographical fragmentation. So, we turned to our network of industry experts from OEMs, suppliers and investors and matched their perspective with our own local experience.

Here is the essence: The car purchasing power of these cities must be firmly in the focus of OEMs today. The population is large, with a certain level of wealth already achieved and more parts of the population on the way to sufficient purchasing power. The sales and passenger car parks are already large and will further increase.

The 3rd market level (cities in tier 4 to tier 6)

The data position is just as bad for these lower city tiers. However, we recommend to not underestimate the importance of this market level. With the continuous advancement of China's urbanization, the automobile consumption potential of the 3rd tier market has grown into an important force in China's automotive market.

With 283 cities, this market level includes the most cities, but their inhabitants are the least affluent. Still, their residents strive for individual and exclusive motorization. Yet, there are a few differences: these city residents focus on value-for-money, have higher level of acceptance for used cars and prefer physical 4S to digital solutions.

Is there still time to conquer the Chinese "countryside"?

It should be clear by now that OEMs need to understand the differences between different city

tiers/market levels. From a brand perspective, OEMs should think about individual approaches for different brand messages targeted at different tiers.

- Higher tier cities are the territory for higher priced premium and top-of-volume JV brands. Expensive NEVs are on the rise and expected to further increase their share
- On the other hand, the lower tier cities are occupied by local Chinese brands and cheaper NEVs

And Chinese local brands are seemingly closing the gap on foreign carmakers. The highlights presented at the recent Beijing Motor Show are just part of an increasingly stronger presence that Chinese local brands claim on their domestic market.

SELECTED HIGHLIGHTS OF THE BEIJING MOTOR SHOW 2020



Source: Press research, Berylls Strategy Advisors

Chinese OEMs rewriting the rulebook

Chinese local OEMs seem to have found their own path to define a compelling value proposition by offering their buyers high value for money to untap demand in the Chinese "countryside". What about German OEMs? It will be critical to achieve a compelling value proposition at attractive pricing like the Chinese carmakers do. However, it cannot be only about making everything cheaper. Understanding how purchasing criteria change when going to lower tiers will be the key discipline. Relying purely on the halo of a premium or even top-of-volume brand promise will not be enough as customers from lower tiers pay higher attention to other pragmatic aspects of the car (space, range, mileage, etc.).

Even more we recommend premium OEMs to rely on more tangible key strengths like their strong product substance. Volkswagen Group (FAW-VW to be exact) has found a way to launch a compelling entry-level value proposition with their Jetta brand a year ago and started to conquest a target group that until a year ago was exclusively approached by local Chinese OEMs. GM (SAIC-GM Wuling to be precise) has gone the same route before with the Baojun brand and had a huge success. Thus, the way to penetrate the lower end markets for premium and volume JV OEMs is

through, the strong sense for “value-for-money” and high residual value.

Going from generic to specific to stay competitive

Yet, the tier system only provides some guidelines for orientation. Just as we have mentioned that “there is no single Chinese customer”, the tier logic is indeed not very precise. And in this case, loss of precision means loss of customers!

So how can OEMs win back lost customers? Big data and social listening can help (as provided by our Automotive Heartbeat software). Using automotive specific and general social media data customer understanding will be much more precise, their preferences, behavior, demands and pain points much more clearer. And if it’s fully automated (like our Automotive Heartbeat), it’s quite simple too.

Using this approach, 3 things can be achieved:

1. OEMs can find those “hidden” customers. For instance, just because a lower tiered city’s average income is low, it doesn’t mean the city residents won’t afford luxury brand vehicles
2. OEMs can sharpen their product offering, branding and communication. This especially holds true for personalized digital content. This means lowered spend with higher conversion rates
3. Customers can be directly engaged online.

Thus, big data is the go-to methodology to detail the generic tier approach.

Yet, if OEMs don’t use the right data sources and content, their social listening tool will provide false results. People in different city tiers use different digital tools and talk about different things. For example: vehicle characteristics: while higher tiered city consumers emphasize exterior, lower tier city consumers also prioritize more practicable things.

Some generics still apply

Still, OEMs can deploy some generic strategies which we outline in the following. With big data, these can be more refined.

Obviously, a dedicated story for communication and marketing in lower tier cities needs to be deployed: in higher tiers, digital elements for communication and marketing must play a decisive role while in lower tiers, it is all about physical vehicle experience through e.g. local car shows.

One might argue that both, building a new story around new products requires some good amount of time. Thus, Display and stock cars need to be different and showroom must be adapted to local tastes. Especially the dealership setup should be done according to tier attributes:

- For instance, higher tier cities’ retail could focus more on the experiential and community building aspects reflecting the higher share of re-purchases and the increased expectations tier-1 customers have towards car makers
- The experiential and community aspects can be gradually reduced when adapting to lower

- tiers. In exchange, technical specifications, and practical features could be highlighted
- The same shall be applied to CI and processes. While large cities should typically feature high CI standard and extensive processes, lower tiered cities can be targeted with a lower cost CI and simpler processes focusing on the functional part
 - Western OEMs could target lower tiered cities with a strong used car push, e.g. through large used cars centers

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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. 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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