



Rising Opportunities in China's Automotive Independent Aftermarket

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Introduction

China's automotive industry has entered a new phase where new car sales growth decelerates, while the car population expands and the average car age increases. This brings enormous opportunities for expansion of the independent aftermarket¹.

In this paper, we examine the complexity of China's independent aftermarket including the distribution channel and service shops. We also examine the key success factors, market dynamics and emerging marketing channels in the independent aftermarket. We will highlight the implications of these developments for key players along the value chain.

¹ *The Explosive Growth Opportunity in China's Automotive Aftermarket, Gao Feng Viewpoint, by Bill Russo, Robert Zhang, and Emily Wang, August 2016*

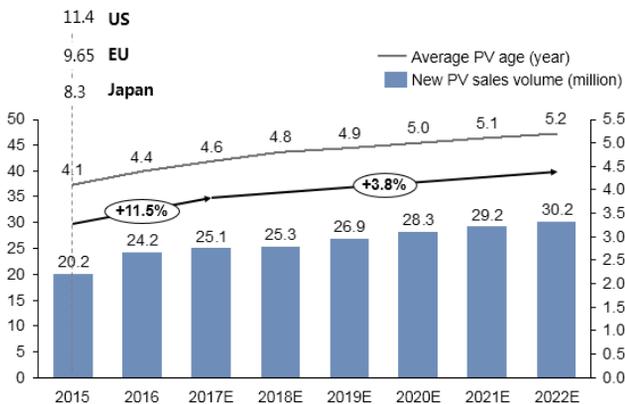
China's Independent Aftermarket Is Rapidly Expanding

China's automotive market is entering a "new normal" phase as the new car sales volume growth decelerates. New car sales volume is estimated to increase at a CAGR of 3.8% from 2017 to 2022, significantly lower than the growth of recent years (see Exhibit 1).

Meanwhile, the overall car population is aging and the average car age is expected to reach 5.2 years by 2022, compared with 4.4 years in 2016. As a result, we expect a golden era for the independent aftermarket (IAM) service growth. As cars age, come out of warranty, and are re-sold, car owners are more likely to have them inspected and served in an independent service shop rather than a 4S dealer. Owners of older cars are more value conscious, and seek flexibility and convenience when choosing a service provider, which will shift the car owner's preference for car maintenance over to the IAM (see Exhibit 2). This offers new opportunities for players in the IAM ecosystem, including auto parts suppliers, original equipment manufacturers (OEMs), 4S dealers, distributors and service shops.

Exhibit 1

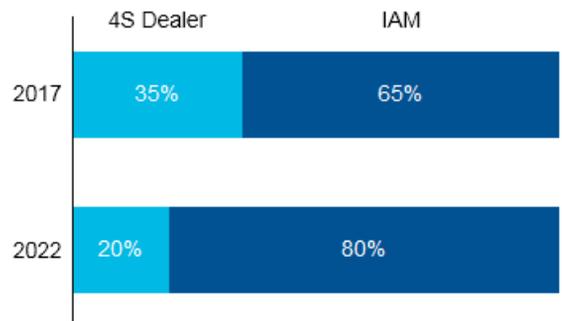
China's new passenger vehicle (PV) sales volume and average PV age



Source: IHS, Gao Feng analysis

Exhibit 2

Car owner's preference for car maintenance



Source: Gao Feng analysis

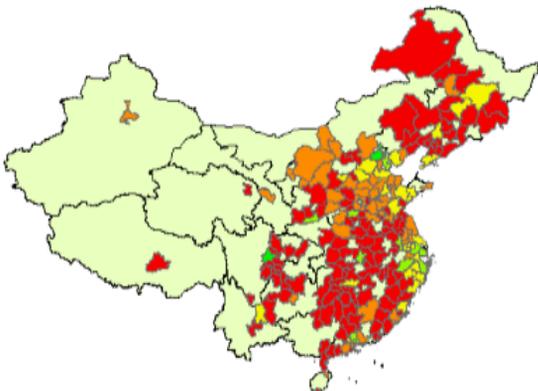
China's Aftermarket Landscape Is Complex and Not Easy to Serve

While large and expanding, the IAM market is fragmented and complicated, making it very difficult to profitably serve. In addition, the automotive market has very diverse characteristics across regions and provinces in China. China's car parc is concentrated in Eastern China, and the mix of car models varies significantly among provinces and different city tiers (see Exhibit 3). Each province or region can be treated as a separate market which requires a different mindset and strategy to conquer.

Further complicating the situation, there is no universal standard or integrated matching system for auto parts in China. Thousands of car models of varying specification from multiple manufacturers and brands are on the road, and each has a different matching system for auto parts management.

Exhibit 3

Car parc of all vehicles by cites: ~110 Mn in 2015 (unit: million)

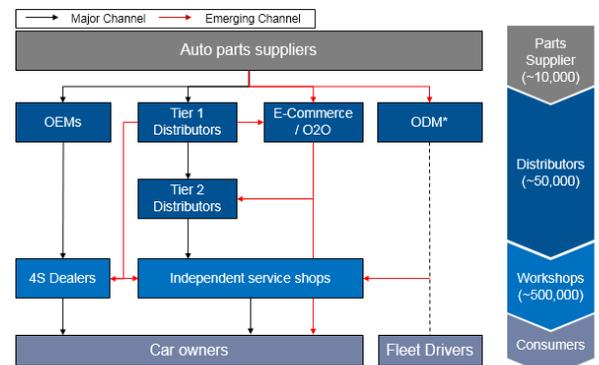


Source: Gao Feng analysis

The service parts distribution channel is complex as well (see Exhibit 4). A multi-tier distribution channel is in place to serve the huge pool of car models in different provincial markets. Typically, a few tier 1 national or regional leading distributors are connected with auto parts suppliers, who then sell to hundreds of tier 2 and lower-tier distributors for city coverage. Each distributor may supply different categories of auto parts for different car models. These distributors then serve over 500,000 service shops, of which only a small portion are regional chained service shops. The vast majority are small local outlets with limited resources and capability.

Exhibit 4

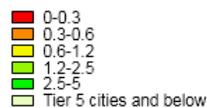
Car owner's preference for car maintenance



Note: On-demand Mobility (ODM) platforms direct fleet drivers to partnered workshops for vehicle services

Source: Gao Feng analysis

- 20% car parc of all vehicles concentrated in the Top 10 cities
- 68% car parc of all vehicles concentrated in the Top 100 cities (tier 1, tier2, tier3 cities)



Service Shops Must Be Trustworthy and Offer Convenience to Car Owners

Most car owners don't like spending a whole lot of time waiting at a service shop. Therefore, a key success factor for a service shop is to have replacement parts delivered from local distributors as quickly as possible, also known as the "last mile delivery". A service shop is usually supplied by 20 to 30 distributors to cover all auto parts for different car models, and they ensure that delivery can be achieved within 1 to 2 hours for common auto parts.

With strong last mile delivery capability, service shops can build long term trusted relationships with car owners. Trust is the key since Chinese car owners are generally young (in 2016, 30% of licensed drivers have been driving less than 1 year).

Exhibit 5

A typical workshop in Shanghai



Source: Gao Feng analysis

There is also no "do-it-yourself" repair culture in China when compared with mature markets like the U.S., and thus Chinese car owners rely on the service technician's advice for diagnosis and specification of repairs needed. Typical car owners shop for service within their local neighborhood and the relationship may begin with simple and regular services such as a car wash or oil change (see Exhibit 5 and 6). After building trust after several routine service experiences many become loyal customers for routine or even more complicated repairs. A typical service shop has 3 to 4M RMB annual revenue, and 80% of revenue is contributed by these regular customers. Service shops are increasing investment in technician training to improve customer service quality in order to retain customers.

Exhibit 6

Auto detailing service by frequency and consumer interaction

Frequency	Service	Price	Gross Margin	Car owners Acknowledge	Relative Level of Trust Required
High	Car Wash	Low	Low	High	
	Polish	Middle	High	High	
	Engine Oil	Middle	High	Low	
	Air Filter	Low	High	Low	
	Coolant	Low	Middle	Middle	
...	
Low	Shock absorber	Middle	High	Middle	
	Tire	High	Low	Middle	
	Brake	Middle	Middle	Middle	
	Chassis and steering	High	Mid	Low	
	

Source: Gao Feng analysis

Mergers and Disruptors in the IAM market

Since the IAM market is huge and fragmented, single players find it difficult to serve the entire market well. Key players along the value chain are collaborating, both vertically and horizontally, in order to strengthen their market influence and share resources (see Exhibit 7). For example, Hella has formed supplier partnerships with Dolz and Bilstein, in which Hella would offer its distribution channels in China. Also, SAIC-GM acquired ACDelco's business in China, and is currently using Delco in the IAM as a secondary auto parts brand targeting price-sensitive customers who are seeking alternatives.

In addition, there are two other types of disruptors emerging in the market: aggregators and consolidators. An aggregator brings together market players and forms strategic alliances, for example the China Aftermarket Auto Parts Alliance (CAAPA) is an alliance among distributors and chained service shops, offering global purchase support to its members. Such an alliance increases the bargaining power of distributors against suppliers. On the other hand, a consolidator consolidates players along the value chain. Carzone is currently one of the largest distributors and covers 27 provinces with over 80,000 SKUs. It competes aggressively through a digital distribution platform and teams up with a wide portfolio of international auto parts suppliers including Bosch and 3M.

The above transformations would take a long time given the complexity of China's automotive aftermarket. Yet, the trend of integration is inevitable and relevant companies must take action.

Exhibit 7

Vertical and horizontal collaboration examples

	Horizontal	Vertical
Upstream OEM/auto part suppliers	<ul style="list-style-type: none"> Supplier alliances / shared sales platform 	<ul style="list-style-type: none"> OEM opens service shops OEM launches 2nd line product 
Midstream Distributors/ 4S dealer group	<ul style="list-style-type: none"> Emergence of cross region multi category distributors & alliances 	<ul style="list-style-type: none"> 4S dealer groups open IAM service shops and launches private label products O2O platform opens service shops 
Downstream 4S shops/IAM	<ul style="list-style-type: none"> Rise of service shop alliance 	<ul style="list-style-type: none"> Chained service shops launched O2O platform/ partnership with upstream players/last mile delivery 
End User ODM/car owners	<ul style="list-style-type: none"> N/A 	<ul style="list-style-type: none"> Didi Chuxing opens car owner club that provides car rental and maintenance services Taxi groups open service shops 

Source: Gao Feng analysis

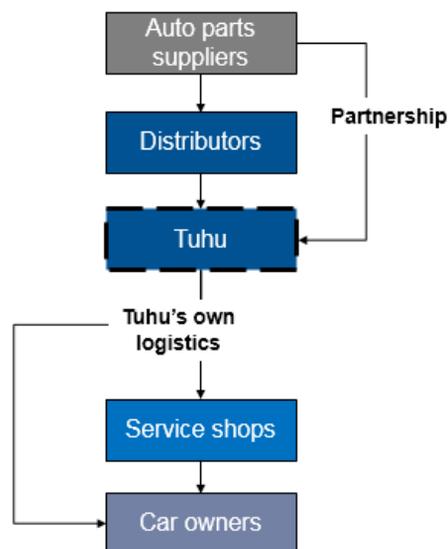
Emerging New Channels

E-commerce and On-Demand-Mobility (ODM) players are attracting a lot of attention as well. E-commerce players that focus on auto parts, led by Tuhu and JD.com, allow car owners to directly purchase auto parts online and have them installed in the designated offline service shops (see Exhibit 8). Currently, some e-commerce portals are mainly used as a benchmarking tool for price comparison, since most car owners have technical barriers in terms of installing auto parts by themselves. E-commerce players also lack the capability of last mile delivery, and do not offer credit sales or financing to service shops as traditional distributors do.

On the other hand, ODM fleets, such as Didi Chuxing, are growing rapidly in China. Many people are satisfying their mobility needs by using ODM services, which drives higher penetration cars in the total car parc being used in ODM fleets. Such cars have significantly higher utilization rates with a correspondingly high need for parts replacement. In most cases, ODM companies and fleet car operators would aggregate the demand for IAM services for their drivers and fleet operators in order to reduce fleet maintenance costs. In fact, ODM service operators will likely become major key accounts for companies competing in the independent aftermarket.

Exhibit 8

Tuhu's homepage and distribution channel



Source: Gao Feng analysis

Digital Marketing Is Efficient

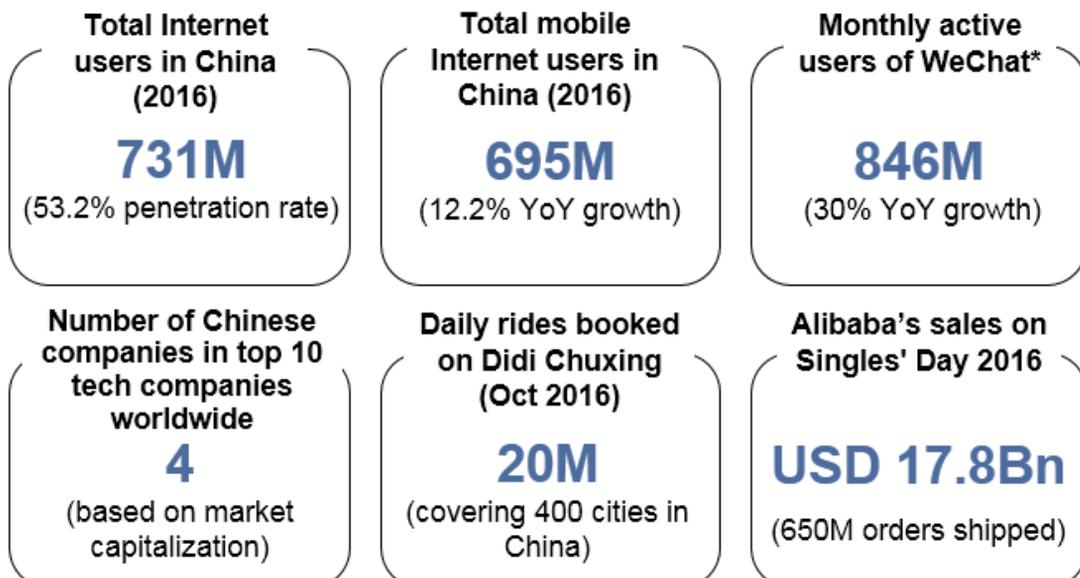
With the world's largest population of internet users, with an extraordinarily high penetration of the mobile internet, China's digital landscape is unique (see Exhibit 9).

Compared with Western markets, Chinese car owners and technicians are in general younger and more open to embrace new ideas, especially digital solutions. A typical Chinese car owner would use Autohome or Bitauto to specify and comparison shop for their new car before going to a physical dealership. Likewise, a technician would use Baidu to research a vehicle and its service parts bill of materials online before determining and pricing a repair order.

This brings unique opportunities for digital marketing and online customer engagement platforms. OEMs and auto parts suppliers can leverage digital tools to engage car owners and service shops and create more touch points along the customer journey. For example, OEMs are now beginning to organize WeChat groups for car owners in order to strengthen the bond between customers and brands. Through online communities and O2O activities, car owners can be converted into brand advocates. Auto parts suppliers can offer technical guidance and online training to technicians through an official WeChat account. Such new and emerging tools provide a mechanism to deepen the relationship with customers and build trust and raise brand awareness.

Exhibit 9

China's Digital Landscape



Source: Gao Feng analysis

Implications for Key Players

OEMs and 4S Dealers

As car owners increasingly choose independent service shops when their warranty expires, OEMs should aim at retaining car owners in the out-of-warranty period. Possible solutions may include extended warranty, introducing a secondary brand for auto parts to deliver good value at lower price, and investing in chained service shops. OEMs could also improve their service delivery capabilities and improve retention through CRM programs.

4S dealers share a similar mission as for OEMs, and they should also consider setting up their own IAM service shops in order to capture the inevitable “leakage” of customers seeking lower price and more convenient service options.

Auto Parts Suppliers

Auto parts suppliers must first protect their core B2B customers: the OEMs and their 4S dealers who are the primary buyers of their products. However, they must aggressively pursue the explosive growth potential in the IAM. Achieving this may require a wider product portfolio to capture a more value-conscious service customer or through partnerships with other downstream parts makers and service providers in order to expand their penetration of the IAM. A multi-brand approach is an option to target customers in different price segments. A new “key account” strategy may be needed to capture a share of the IAM business served through E-commerce and ODM platforms. Key successful factors include, but are not limited to, flexible production of differentiated products, recognizable brand names, consolidated marketing and an effective multi-tier distribution channel.

Distributors

Distributors should consolidate and aggregate their businesses to optimize their ability to balance supply and demand while achieving scale. Carzone and Autozi are examples of Chinese consolidators and aggregators. Distributors must also expand their product portfolio and explore e-commerce partnerships to broaden coverage of 4S dealers and service shops.

Service Shops

Service shops should build their trustworthiness and reputation by providing better and consistent services, as well as by joining alliances which improve their bargaining power relative to their upstream partners. E-commerce should also be leveraged to attract online car owners to offline shops. Unlike 4S dealers, service shops must serve a wide range of brands and models which drives a significantly larger pool of auto parts, creating opportunities for segmenting and serving the market in a more flexible way. Service shops must also leverage CRM programs to retain the loyalty of service customers, which may include brand affiliations, targeted marketing, and local community and auto enthusiast events.

Conclusion

China's auto aftermarket is an explosive growth opportunity for organizations that are prepared to adapt their approach to the China context. As the China market enters a more mature stage with slower new car sales growth, key players must act now to find opportunities to profitably grow their participation in this business. Unlocking this potential will require an expanded set of capabilities, often developed in collaboration with new partners offering a combination of products and services to maturing market.

About the authors

Bill Russo is Managing Director and the Automotive Practice leader at Gao Feng Advisory Company based in Shanghai. With 15 years as an automotive executive, including over 11 years of experience in China and Asia, Mr. Russo has worked with numerous multi-national and local Chinese firms in the formulation and implementation of their global market and product strategies. He was previously Vice President of Chrysler North East Asia, where he managed the business operations for the Greater China and South Korea markets. Prior to this, Mr. Russo was Head of Product & Business Strategy for Chrysler. He also has nearly 12 years of experience in the electronics and IT industry, having worked at IBM Corporation, and formerly served as Vice President of Corporate Development at Harman International.

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