

China's Automotive Aftermarket: A Strategic Opportunity

By Michel Brekelmans and Ken Y. Chen

Over the last decade, explosive growth in China's automotive market has made China the largest auto market in the world. While the focus has previously been on new auto sales, recent interest has shifted to the development of China's automotive aftermarket. The aftermarket is in a relatively early stage of development and there are several characteristics unique to the China market.

WHAT IS THE SIZE OF THE PRIZE?

Driven by huge growth in new car sales, China's stock of cars, especially older vehicles, is expanding dramatically. China has experienced annual growth of new car sales at around 20 percent over the past 10 years, and strong growth is expected to continue. This is having the secondary effect of dramatically increasing

the stock of cars in China. Furthermore, we estimate that by 2017 the average age of cars will increase from 3 years to 4.5 years, the age when spending on aftermarket parts and services will typically peak. This aging of the fleet is expected to result in the number of 'out of warranty' vehicles dramatically increasing during the same period. This will further drive demand for aftermarket products and services, especially from the non-OES network.

Based on prior case experience we know that these factors are likely to create substantial demand for aftermarket parts and services. The size of the market has already increased dramatically from US \$10 billion in 2008 to US \$24 billion in 2012. This trend can only be expected to continue as China's car fleet both increases and ages.

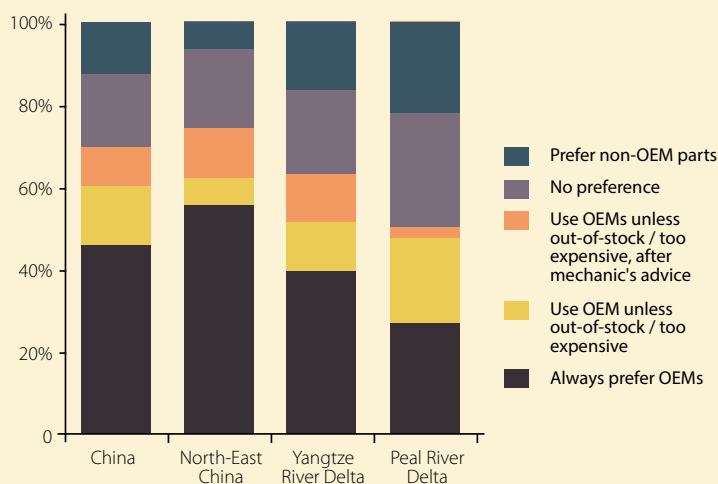
HOW ARE THE AFTERMARKET CHANNELS STRUCTURED?

In terms of the value chain, key stakeholders and suppliers are crucial when developing a winning strategy. They will fundamentally differ based on product type, manufacturing background, geographic market and the development level of each city. As part of a growth strategy project for a leading US automotive aftermarket supplier, L.E.K. defined the industry structure and identified attractive growth opportunities considering the market dynamics and the client's core competencies. A requirement was to build a dynamic picture of how the industry is expected to develop in the coming years.

Currently 4S stores, "Four in One" vehicle stores (including sales, spare parts, service, and survey feedback) hold the largest channel share in China, although chained repair shops are forecast to increase in relative importance over the coming years. Direct channels, including self-owned/self-branded stores and online distribution, currently account for less than 1 percent of the private car market but may be positioned for strong growth.

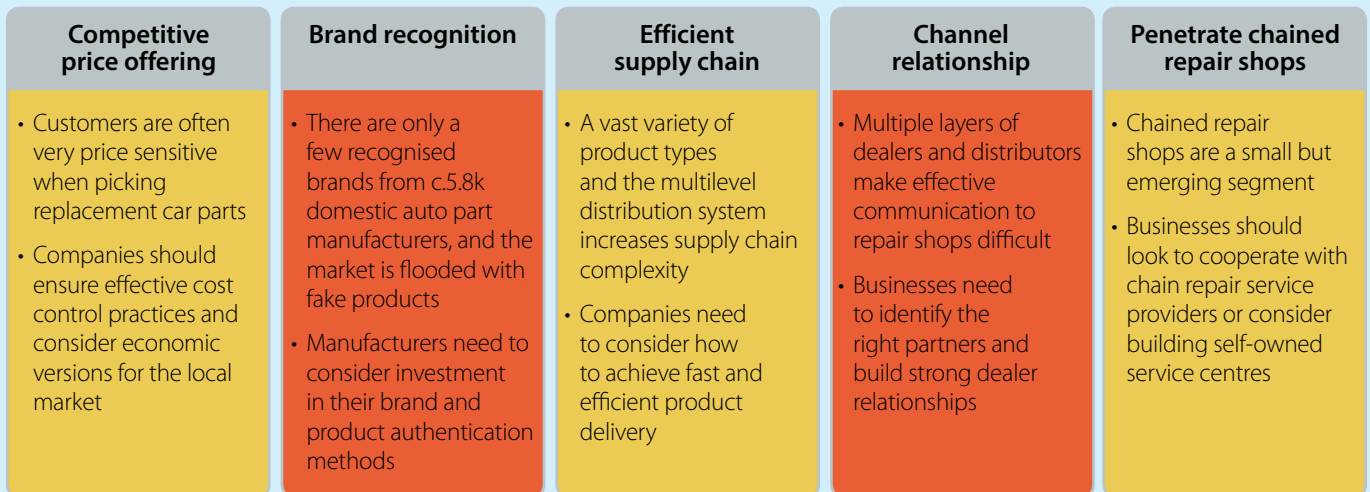
Besides changes in channel mix, another

PREFERENCE BETWEEN OEM AND NON-OEM PARTS BY LOCATION



Source: L.E.K. research and analysis

CRITICAL SUCCESS FACTORS IN THE CHINA AUTOMOTIVE AFTERMARKET



Businesses competing in the China automotive aftermarket need to consider local critical success factors

important trend will be increasing levels of industry consolidation. Government policy directives, including the 11th Five Year Plan, have been issued during the past decade aimed at decreasing the number of auto-component suppliers to increase scale and competitive capabilities. Additionally, a National Development and Reform Commission 2006 mandate encourages merger and acquisition activity in the sector. Every year we are seeing hundreds of domestic transactions in China's automotive sector, which suggests the government's ambitions for a stronger home-grown automotive supplier base are gradually taking shape.

CUSTOMER SEGMENTS AND BEHAVIOR

Currently, most car owners use 4S stores for their aftermarket needs. However, consumers that purchase their vehicles privately (as opposed to company cars, government cars, etc.) are more likely to use non-4S service centres. These consumers are typically more price sensitive and may have greater automotive knowledge. The current presence of the OES network (i.e. 4S stores) is still dominant even in the private car repair market, and has been estimated at 70 percent.

Differences in consumer behaviour have been observed depending on what service or product is required. Consumers who require more crucial mechanical repairs, particularly those related to safety, may be more inclined to use a 4S centre. However, other factors, including price, convenience, product availability or technical expertise, influence or determine service centre selection.

Typically consumers have a preference for

OEM parts, with the majority of consumers likely to choose 4S centres as their first choice. However, surveys have indicated there are some regional differences in consumer preferences, for example, people in Northeast China are more likely to prefer OEM parts. There are also large differences between reported 4S auto part sales, and the estimated demand for 4S parts. This is likely due to a willingness to use other brands and the prevalence of counterfeit parts in the marketplace.

DEVELOPING A WINNING STRATEGY

The dynamic nature of the Chinese market means there are several key factors that will determine success. Consumers can be very price sensitive and there is generally low brand awareness. It is not uncommon for a BMW owner to shop around and save a few RMB on an oil change for instance – haggling for bargains is a key trait of the Chinese consumer and car-owners are no different in that respect. In such an environment it becomes critical to position the company correctly and align products, price and channel strategies accordingly.

In China, the component supply chain is long and complicated, and there are typically many levels of distributors. Design and management of the go-to-market and supply chain assets will determine success or failure in the industry. 🚫

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