

China *Certification*

Market Report 2012

The US-Automotive Industry in China Outlook and Recommendation



Quality Leadership is Key to US Automotive Industry's Success in China

This report contains a market analysis of the Chinese market for luxury cars and how US automotive manufacturers are performing in comparison to other car exporting countries. Since most passenger cars imported from Western countries to China are luxury cars, this white paper contains an analysis of the preferences of the Chinese premium car buyer and information regarding the market for luxury items. The conclusion of this report is a recommendation as to where US automotive manufacturers should invest their attention in order to ensure their ongoing success in China.

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1. Introduction

The outlook of the US automotive industry in China is currently very good. Chinese streets are becoming saturated with European, especially Germans cars, and the preferences of premium car buyers in China are changing in favor of US car brands. Large, robust cars and SUVs are selling increasingly easier, as these cars' features are especially useful to buyers in booming hinterland provinces of China.

The market for luxury goods in China in general is growing incessantly as the number of high and ultra high net worth individuals is closing in on the 3 million mark. And even though the government has high taxes on luxury items in place, the buying spree is not being impacted significantly. There are many cultural reasons that help explain why the craving for luxury goods, especially cars, is so strongly developed in China. Understanding these cultural preferences gives car manufacturers an edge against their competition. They can accentuate their offer with features that are irresistible to the Chinese buyer.

In the future, it will be more important for car manufacturers to approach the Chinese buyer with a complete set of China-Specific marketing skills and individualized products, as the competition in the premium car segment is continuously growing and the Chinese infrastructure, especially in the megacities, will become too congested.

2. The Chinese Premium Car Buyer

To understand the Chinese premium car buyer, it makes sense to look at two different groups of this exclusive class of consumers. The high net worth individuals, numbering roughly 2.7 million people, differ in certain aspects from the approximately 64,000 ultra high net worth individuals, which have around 10 times more income at their disposal than the former group.

Both groups' similarities can be summarized in that their source of wealth comes from their companies (followed by stock market investment and real estate), they are entrepreneurs. With around 20 days of holiday per year, traveling is an important pastime, with golf being the favorite sport (followed by swimming, yoga and climbing). High net worth individuals tend to also be family people, 8 out of 10 have children. Car manufacturers might find it noteworthy that 35% of high net worth individuals keep pets, with younger high net worth individuals being even more enthusiastic

about pets (44% keep a pet). Large dogs are the most favorite kind of pet, making up roughly half of all pets owned by high net worth individuals.

While the typical Chinese high net worth individual will always enjoy a red wine, many do not indulge in hard liquor and only half are smokers. Both groups of high net worth individuals own in average three cars, while ultra high net individuals however differentiate themselves by owning a significantly higher number of luxury watches. Interestingly enough, Chinese high net worth individuals of all classes never stop investing in their abilities, more than 90% participate in self-improvement training and educational programs (an equal number sends their children abroad for education). They enjoy making charitable donations (some have donated as much as 40% of their wealth to charity) and pay their taxes regularly as a way to show social responsibility. They are charitable even without being invested in any kind of spiritual orientation, only half of all high net individuals in China have a religious faith, 70 to 80% of believers follow Buddhism.

The strongest differences between high net and ultra high net worth individuals is in the demographical structure, with ultra high net worth individuals tending to be older (average of 41 years) and more male (80% are male, versus only 60% among their lower-earning counterparts). It is also true that 75% of ultra high net worth individuals are collectors (watches, classical paintings and calligraphy being the favorite items), while this is only true for one third of high net worth individuals. Also geographically, while high net worth individuals are spread more evenly across China (with the eastern coastal provinces and generally eastern China outpacing the Western and Northern provinces), the ultra high net worth individuals are concentrated in the megacities, with Beijing leading. Beijing together with Guangdong and Shanghai hold almost half of all high net individuals.

Half of high net worth individuals believe that brands stand for higher quality and especially ultra high net worth individuals crave to see premium prices on the products they buy as every fourth sees price as a guarantee of quality. Average annual spending is \$230,000 for high net worth individuals and \$424,000 for ultra high net worth individuals, with men spending in average 15% more than women. Almost 70% of high net worth individuals see their consumption rising in the future, one fourth expects it to remain equal and only 6% expect it to fall.

For 33% of high net worth individuals, driving is their most favorite leisure activity. Figures show that this percentage is much higher with younger people (under 30). 41% of younger high net worth individuals named driving as their favorite leisure activity. While the average number of cars owned is very similar between high net worth individuals and ultra high net worth individuals, it is noteworthy that in both groups there are a percentage of people who seem to be collectors of cars, owning more than five cars. This percentage lies at only 7% for high net worth individuals but is more than twice as great with ultra high net worth individuals (16%). And while roughly every fourth high net worth individual only has one car at his disposal, this percentage is 10% less with ultra high net worth individuals.

3. The Chinese Market for Luxury Cars

In 2009, China had for the first time greater car sales than the USA. In 2011, the China Association of Auto Mobile Manufacturers (CAAM) witnessed sales of passenger cars in the region of 15 million units, an increase of 2.4% after spectacular anterior years (2009: 46,2%; 2010: 32,4%). Growth is to pick up again in 2012 to reach 8-10% according to the CAAM. Experts say slumping growth in 2011 was owed to the fact that subsidy programs ran out. Also due to inflation, there were fewer loans issued to consumers and enterprises, further hampering sales.

But even when sales of passenger cars in general are stagnating, in the segment of luxury cars the growth is still in the double figures region, oscillating around 30%. Until 2011, Germany was the second largest market for luxury cars in the world, but in 2011 was third-placed by China by 54,000 units, with 969,000 units of luxury models sold in China. Though the largest luxury car market of the world remains the USA, it is only a matter of years until the United States likewise will have yielded the first place to China.

In-Sync with the positive prognosis of the CAAM concerning the Chinese automotive market in general stood the prognosis of the China Machinery Industry Federation (CMIF), which stated in their most recent report that the number of automotives on Chinese roads will double from 100 million counted in the end of 2011 to 200 million in 2020. Growth will come from the second and third tier cities and neglected hinterland provinces.

Newest reports show that even though the domestic Chinese automotive industry is making progress and increasing sales, foreign car manufacturers still hold the high ground when it comes to cars valuing above \$16,000, which represents 73% of total sales. In this category foreign car manufacturers dominate the market to 99%, according to figures published by the Chamber of Commerce of Germany. Germany is the absolute leader in premium class exportations of automotives (cars valuing above \$45,000) with almost three fourths of market share.

US car exporters in the meanwhile are making excellent progress with their exports to China. Especially General Motors is celebrating success with Buicks and Chevrolets, hounding as a close second, first place positioned Volkswagen. Judging by the growth rate of 19% compared to Volkswagen's 15%, it will catch up soon enough. General Motors will also introduce 5 to 10 new Cadillac models to China until 2016 and wants to even build a factory in China exclusively for Cadillacs. With this, GM puts its expansion strategy in line with other very successful brands, such as BMW which is currently doubling its domestic production in China to 200,000 vehicles per year, Ford also is currently investing \$600 million in a plant in China.

Cadillac has not been doing so well in the US luxury car market and its market share is dwindling, currently standing between 1.2 and 1.5%. In China however, Cadillac is very successful and the company is confident that the sales volumes of Cadillacs will be matching those of the US by the middle of the decade. GM chief executive Dan Akerson was quoted during the Beijing International Automotive Exhibition 2012 saying that every manufacturer must have a very strong and successful luxury brand to effectively compete in China.

Generally, the manufacturers are in agreement when it comes to the speedy development of stronger competition in China. Jaguar for instance stated that its special version of their XJ Sedan called the XJ Ultimate, with embedded iPads, concealed champagne flutes and champagne cooler, is largely a result of wanting to distinguish itself from competition by adding exclusive bonuses for the models that are to be marketed in China. The trend of catering to the needs of the Chinese premium buyer by offering special versions of tried and tested luxury car models is indeed omnipresent. Nissan for example created a special edition of their midsize Sedan "Infiniti" with roomier backseats for Chinese owners that employ personal drivers. Many luxury carmakers such as Rolls-Royce (who created a special version

of a model exclusively for China with lightning systems built into the interior roof of the car to imitate a star-spangled sky in the night) and Lamborghini (dragon designs on seat stitching and shift stick) claim that China is their number one important market.

Many manufacturers also ride the trend towards having a larger SUV type car. While in the USA and also in Europe consumers tend to downsize their car as gasoline prices skyrocket, in China and especially in the hinterland provinces SUVs sell very successfully, with growth rates averaging 15% per year. Famous brands such as Lamborghini (Urus), Bentley, Maserati (Kubang) have developed or are developing SUV type cars. Bentley claims China to be its second most important market, so they decided to develop several models specifically for sale in China. Range Rover, the premium model of the Land Rover family (with some versions costing as much as \$500,000) are very popular in the northern provinces and sell to the descendents of Mongolian farmers who have become rich thanks to their new mining businesses.

Mercedes has been selling very successfully in China, tripling its number of outlets in the last five years, with 12% strategically positioned in smaller cities. Plans are to further double their number by 2015 and having roughly one fourth of all outlets installed in smaller city locations. The manufacturer is preparing for bigger competition and higher restrictions in the urban centers and is preparing to harvest the potential of the neglected provinces.

The first-mover advantage in China gives brands tremendous recognition. Porsche and Audi are two of the most successful car brands in China. Porsche for instance has in the first three months of 2012 experienced 80% percent growth in their sales volume. Porsche expects that the number of luxury cars sold in China will have tripled by the year of 2025. Audi on the other hand increased sales by 70% in 2011. One of the reasons why Audi is so successful is because they provided very popular government cars ever since 1990, Porsche was one of the first brands to be discovered by China's entrepreneurial pioneer generation.

US automotive manufacturers are clearly behind in China compared to German and Japanese manufacturers, but the trends are strongly in their favor. The coming years will see a strong surge in the number of US cars on the road in China and companies such as GM, Ford and Daimler will see their sales figures buoying significantly. Experts observe that the competition in the luxury car segment has forced many

major brands of luxury cars to put more emphasis on after sales services, trying to build their long-term reputation by bestowing upon buyers exceptional attention. They are trying to build very tight service nets so as to ensure that their brand can be serviced throughout China and is present in the daily life of the consumer. This is a field where US manufacturers can levy their strengths as they are experienced in providing excellent client service, which traditionally matters a lot in the USA.

4. Conclusion and Recommendations

For car manufacturers around the world and especially for luxury car makers, China will remain the most important market in the coming years. The growing number of high net worth individuals displaying more mature buying decision preferences, combined with an increasing consumption rate and greater awareness to the social transformations make for a stimulating mix of market factors which will continue to fuel demand until the end of the decade and beyond.

As such strongly impacting trends do not go unnoticed, car manufacturers are positioning themselves more aggressively in China and have started to become more competitive, offering innovative extras and special attention to tighten their hold on the fastest growing luxury car market of the world. They are building networks of after-service infrastructure and sales points and spend enormous sums on marketing and PR. As the competition is growing stronger, manufacturers will find themselves struggling to identify further ways of differentiation. Possibly they will start splitting up their lines in a high grade premium class and more affordable models. This would allow differentiation on the price level, reflecting the reality of many middle-class Chinese enterprises and white collar workers that do not have such unlimited wealth as the high net worth individuals. From this stage it is possible that price competition may erupt.

In the lowest pricing category however, there is no room for foreign car manufacturers, as this market segment is occupied by Chinese domestic manufacturers. On the other hand, it is not expected that domestic manufacturers will reach a level of quality and reputation that would allow them to compete with foreign manufacturers within the next eight years.

Considering the evolution of the Chinese luxury car market and the strategies the manufacturers are pursuing at this moment, the following recommendations can be

made for automotive manufacturers who want to build a sustainable market position and ensure growth and participation in the Chinese boom: Special editions and individual accents such as Dragon designs and the like will not hold the attention of the Chinese consumer for long as they become more common. Manufacturers must analyze the needs of their target group on a more fundamental level. It is proven that the Chinese consumer holds quality in high esteem, visible quality that communicates his or her social status. Furthermore, the Chinese consumer has many other properties (leisure activities, family and pets, health and wellness, hobbies and collections etc.) that allow car manufacturers to exploit a variety of niches to cater to the specific needs of individual customers. Considering the boundlessness of the typical Chinese ultra high net worth individual's pockets, manufacturers need not fear the investment in research and development to come up with perfect solutions for varying client needs.

Furthermore it is a good idea to anchor the brand in everyday life in Chinese cities and be on the front line when it comes to developing the hinterland's distributional and service channels. Placing themselves in good exposure before other brands follow is the key to bind clients to the brand at an early stage and saturate the capacities for luxury cars before a competitor can. Though the Chinese automotive market seems so limitless, saturation tendencies will start affecting manufacturers' market strategies before long. Being the first is very important even for the long term, as can be seen by the example of Audi, who have based their current success on positioning themselves as supplier of government cars in the early 90s.

4.1. Further Recommendations

While the market for luxury cars is strong, there are factors when exporting to China that sometimes manufacturers do not take into account, such as the Chinese quality certification system CCC. Export is barred to all manufacturers whose products do not carry the safety seal CCC, the China Compulsory Certificate. It has happened before that manufacturers were confronted with substantial delays of a new launch or were unable to provide spare part shipments due to CCC problems.

The CCC is a quality-control certificate awarded to manufacturers that comply with a specific set of standards for products defined in a catalog issued by the China Quality Certification Center (CQC), the authority in charge. The CCC was introduced in 2002

and currently applies to 26 different product groups, common ground being their usage by Chinese consumers.

To obtain the CCC and therefore own the key to legally exporting to China, a manufacturer has to follow a set of procedures defined by the Chinese authorities. The full certification cycle takes between three and four months for automotive suppliers and can take up to a year for car manufacturers to complete when everything is done correctly. What follows is a brief overview of the necessary steps to obtain CCC:

- Apply to the authority in charge of one's product segment with documents containing specifications of the plant and the products to be certified
- Have the products that are to be exported tested in Chinese testing facilities according to the GB standards
- While the testing is underway a factory audit has to take place, involving two Chinese auditors examining the manufacturers' plant and using specific checklists issued by the authorities
- Once a positive outcome has been achieved, the certificate is awarded and a printing permission can be solicited. Once the permission has been granted the manufacturer is free to stamp/label his certified products with the CCC logo and the export operation can be initialized

At first glance the process sounds easy enough to conduct, however this was a very brief and simplified version of the actual procedure. Along the way there are many possible pitfalls to avoid. For instance it may be advisable to hold back certain product specifications in order to protect critical intellectual property, or it may be wise to create unique product numbers that are specifically created for products bound for China, as sometimes only small changes of the product can otherwise trigger a CCC certificate to become void. Displaying cultural sensibility and having an expert interpreter at one's disposal when dealing with Chinese auditors are required.

Fortunately, since the CCC has been introduced almost 10 years ago, a number of competent service providers have sprung up to offer comprehensive consulting

services. When searching for such a provider the following items should be taken into consideration in order to choose well:

1. Office in the country/region of production but subsidiaries in China to guarantee excellent customer service and close communication with Chinese authorities and test labs
2. Long-standing contacts to authorities, knowledgeable interpreters and quick reaction times to potential clients' inquiries
3. Full-Service solutions covering all necessary areas of certification, while still offering transparent pricing and insurance against currency fluctuations and tariff changes

In conclusion it is surely right to say that even though CCC is a trade barrier, which needs to be overcome in order to succeed in China, the effort is well worth it. The very strong growth of the automotive sector in China will not wane soon. Automotive manufacturers and suppliers are well advised to take necessary measures to obtain CCC in a timely manner. Once the CCC has been successfully obtained, export operations can be staged smoothly.

5. About China Certification

China Certification Corporation provides all-inclusive services for any need regarding CCC export certification for China. With 7 years of experience, offices in the US, Germany and China and good contacts with authorities and test labs, clients can expect Grade-A consulting services delivered.

Our list of clients includes automotive industry leaders such as Bugatti, Webasto, Faurecia, Cooper-Standard, Farmingtons, IAC Group, Continental, Dräxlmaier, FICOSA, Johnson Controls, Peguform, Kirchhoff Automotive, LEAR Corporation and many others.

Automotive suppliers and manufacturers are invited to download our free 24-page information booklet "CCC Made Easy", available at

www.china-certification.com/en/downloads.php

For further resources or any other enquiry, please contact



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