Perspective

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Revving Up Chinese Automotive Brands

Challenges and Opportunities in Chinese Carmakers' Quest for Lasting Value

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Revving Up Chinese Automotive Brands

Challenges and Opportunities in Chinese Carmakers' Quest for Lasting Value

Carmakers that seek to understand and capitalize on the power of brands must first understand the emotional resonance of cars in the lives of consumers. Cars are arguably the second most expensive item that most people buy in their lives, superseded only by houses. They reflect far more than their owners' transportation preferences: Cars provide clues as to their owners' aspirational or actual social status, their leisure activities, and their entertainment preferences.

Decades of consumer research from developed auto markets around the world show that consumers' perception of a certain vehicle counts for as much or more than the vehicle's functionality, in determining how much a customer is willing to pay for it. That's why a brand is far more than just a name or a way to describe a car model or its underlying functionality. A vehicle's brand communicates the fundamental purpose of a vehicle to the owner, and seeks to fit into the owner's lifestyle.

BMW, Ferrari, Volkswagen. What do they have in common? From a technical point of view, very little. No one would mistake one for the other. Yet each is a globally known brand with a highly distinct positioning. Most consumers, given a brief description of each, would easily be able to associate the brand with the functional description. Moreover, most consumers would also be able to identify the essence of what these vehicles represent in terms of the lifestyles and aspirations that their owners seek to identify with.

In China, however, the automotive market is still in its infancy in terms of the brand development that would allow such associations: Customers are only just beginning to understand the brands available in the market and to express preferences among them. Although this means a lot of work ahead for carmakers, it also means that Chinese consumers are ripe for targeting.

So what does it take to achieve the iconic status of a globally recognized brand? Moreover, why should Chinese carmakers attempt to reach that status?

Car brands are basically the means to distinguish one's products from a competitor's by capturing the core of the company and its value proposition. They are also a promise of a certain level of quality, functionality, and performance. Ideally, a car brand should embody and summarize the essence of what a vehicle feels like and what it will deliver. Brands can be strong tools to optimize vehicle pricing, as the example of the Volkswagen Sharan, a European minivan, shows: VW is able to achieve an MSRP of 2,000 to 3,000 euros higher for the Sharan than Ford for the Galaxy, although both vehicles are virtually the same. Why? Because of the value of the brand.

The Challenge for Chinese Vehicle Manufacturers

Chinese companies have only recently embarked on the long journey of building up powerful brands. Research from leading advertising agencies in China has shown that although target consumers are often highly aware of Chinese brands across consumer product categories, the value of these brands is still quite low. Furthermore, for some consumer products in China, the costs of brand maintenance—including the costs of building awareness and promoting usage—have often eroded the price premiums that Chinese brands have over unbranded products.

Research shows that Chinese customers are still in the process of forming brand preferences in the automotive sector. To the extent that they have, however, foreign brands are the clear winners at this point: Chinese consumers are very willing to pay a premium for foreign cars, which they believe offer higher quality and performance. Chinese brands have yet to earn that reputation. The 2006 Apeal data from J.D. Power Asia Pacific underscores that foreign brands lead in all vehicle segments in terms of customer satisfaction.

Furthermore, there is relatively little loyalty to vehicle brands. For example, in a survey of current Chinese car owners, the percentage of current owners willing to buy their current compact models again across foreign and local brands ranged from a low of 3 percent to a high of 11 percent. By contrast, when Japanese car owners were asked the same question, they expressed a 50 percent likelihood of buying the same model again. While a model is narrower than a brand, and thus a less likely candidate for a repeat purchase, the point is that preferences among Chinese consumers are still in the process of being formed.

In 1999, Booz Allen did a comprehensive study of the Chinese automotive sector. In that study, one idea that resonated very strongly with foreign and local auto industry experts was that Chinese vehicle manufacturers (VMs) could ultimately point to their ability to understand Chinese customers and build powerful brands as a significant point of differentiation. Subsequent research continues to support that idea. As we look to China's neighbours Japan and Korea, it is clear that vehicle makers from these markets, from a branding perspective, are much more globally established today than their Chinese competitors. Some of the leading players from these countries have built powerful brands at par with and even beyond many of their foreign competitors. Companies like Toyota, Honda, and Hyundai started at home and then developed brands for their target markets abroad—in particular, the United States. Chinese automakers are now starting to go up the learning curve and have taken huge strides in 2006 to keep up. And at least some Chinese automakers are attempting to shorten the learning cycle by hiring world-class design talent to accelerate the process.

Building brands, however, will be a key challenge for most Chinese VMs for several reasons. First, the concept of a brand—in any sector—is still fairly novel in China. This means Chinese carmakers have little domestic experience with building brands, and cannot look to peers in other industries, such as consumer products. Second, carmakers will have a lot of competition from foreign brands that have already staked out positions in the market and are spending heavily to reinforce these positions. Third, Chinese customers switch brands frequently, which makes it difficult for new brands to understand who their true target customers are based on actual, repeat purchases of a specific brand.

Chinese VMs' initial attempts betray numerous shortcomings and echo the failures of other Chinese companies. Chery is one example of a company with a successful product but a less successful brand. Chery has chosen to position itself as a "popular" brand that is economical and practical, at a price below RMB200,000. Although this is certainly a suitable brand position, it is not necessarily distinct; there are many ways to be practical and economical, and that will make it difficult to communicate differences to consumers as other brands also seek to position themselves against these broad brand attributes. The risk to Chery is that competitors will position themselves in the same space with a more distinct aspect, targeting the more profitable sub-segments that Chery is attracting today.

How Brands Are Developed

History shows that car brands often hearken back to the lineage of a vehicle and what the first models represented. For example, Mercedes-Benz (luxurious), Ford (affordable), and Porsche (sporty) have not changed their brand characteristics since their early days. Vehicles are first and foremost the personification of car brands: They need to exemplify the characteristics of the car brand, which means that changes are to be avoided or very carefully managed. BMW, for example, protects its sporty, dynamic brand image and has therefore chosen to stay with rear-wheel-drive vehicles against all odds, even for compact cars. BMW aficionados would agree that BMW has always been "the ultimate driving machine," even if this brand description was developed only late in BMW's brand history. The distinct front slope of the hood on a BMW is a timeless feature that is easily recognizable.

VMs have at times been tempted to stretch their brands to cover more models and segments. This needs to be done very carefully as brands are only so flexible. Customers, for example, still do not accept luxury vehicles from Volkswagen, as the company has bitterly learned with the underwhelming performance of the Phaeton.

Established companies that have learned from experience will therefore take significant steps to protect their brand heritage when positioning themselves in China. Some companies, like GM and Honda, have successfully moved their brand positions in China upwards. Yet China is a large enough market that it would be naïve to believe that all customer segments either are being or will be fully addressed by existing foreign brands. Herein lies the most fundamental opportunity for Chinese VMs: to leverage their unique understanding of consumers to develop and maintain brands that are distinctly Chinese in nature and that address needs left unfulfilled by competing multinational companies.

Given the inherent opportunities for Chinese VMs, as well as the penalties of failing to develop strong brands, it will be critical for Chinese VMs to make the right product decisions when developing their own branded vehicles. Chinese carmakers, who are unfettered by any constraining "heritage," enjoy a degree of freedom in determining their brands and the characteristics of their branded vehicles that the foreign players simply do not have, unless they also develop brands that are new to China.

How Companies Communicate Their Brands

While the car itself will remain the most important embodiment of the brand, dealers and marketing communications are the most important channels for communicating the value and promise of a brand and in positioning it.

To protect a brand's promise, the after-sales experience needs to be carefully designed and executed. Given the recent advent of Chinese auto brands, establishing strong, branded dealer networks will be imperative for most Chinese carmakers. Carmakers will also need to find business models that will ensure sufficient dealer profitability. New Chinese regulations since the beginning of 2007 now require captive dealer networks, which are dedicated to a single vehicle brand. With this regulation, the opportunities for minimal investments in dealerships in the future will be significantly diminished. Chinese VMs that operate in joint ventures with foreign partners will face the challenge of establishing their own dealer networks and combining coverage with high capabilities. Like privately owned companies such as Geely or Great Wall, they will enjoy high degrees of freedom when developing their dealership formats, networks, franchise business models, and network coverage.

In addition to building suitable dealer networks, Chinese companies will rely heavily on marketing and media communications to promote their brands. Chinese customers are known to evaluate at least three different brands prior to making their purchase decisions. The Internet, therefore, is the ideal medium for them to compare offerings, vehicle features, and prices and will offer VMs a low-cost channel for extensive brand communication. Chinese carmakers should therefore also leverage direct marketing channels to reach single customers effectively. This could manifest itself in using sales agents or other forms of one-to-one marketing.

How to Position Chinese Brands

Our studies from mature markets show that customers select and judge brands by two "mega-attributes": Cost of ownership and vehicle excellence. We hypothesize that the Chinese market will develop in a similar direction. In China, these attributes can be defined as follows:

Cost of ownership:

- Economical to operate
- Excellent fuel economy
- Good value for money
- Acceptable lifetime costs

Vehicle excellence:

- Large vehicle size (LxWxH)
- Attractive styling
- High safety standards for occupants
- Prestigious
- Luxurious
- Acceptable horsepower
- Acceptable handling
- Extremely dependable

In all likelihood, most Chinese carmakers will initially position their cars in the mass market segments because of their likely low cost positioning and lower, average customer acceptance, at least for now. These vehicles typically cost below RMB100,000 and are viewed as a "value for money" purchase. It is an area of the market that is currently already dominated by Chinese brands.

Although many Chinese companies may start out in the mass market segment, that may not be universally true; and Chinese VM's who start with this positioning may not be content to stay there. SAIC, for instance, is working hard to differentiate itself in the higher-end segment. Other companies that get traction in the mass market segment will almost certainly diversify their branding positions in an attempt to move towards higher priced vehicles.

For mass market cars, quality plays an important role in customers' buying decisions. According to the J.D. Power Initial Quality Survey, Chinese cars still suffer from poor initial quality, although this can be expected to improve in the coming years. "Made in China" has not reached comparable status with foreign brands in the eyes of the Chinese consumers, nor will it, until credible data are available that attest to such improvements. Chinese consumers are value-oriented and inherently sceptical, and for good reason, given their past experiences with a wide array of consumer goods in China. Reliability and durability are important for consumers as well because life-cycle costs depend on them. The combined quality/reliability/durability (QRD) positioning of Chinese cars needs to be improved to justify acceptable price levels.

Within the mass market segments, Chinese carmakers have limited degrees of freedom to establish themselves and their brands in new areas of the market and with new brand attributes. The major reason is that midsize and large market segments in China are very crowded already, and suffer from cut-throat price competition. Foreign and domestic players compete head-to-head in those segments. Chinese VMs could attempt to differentiate their brands and cars through newer or more attractive attributes. Chinese carmakers could, for example, choose to develop midsize vehicles with innovative crossover body styles and fashionable interiors.

There are numerous possible brand attributes that Chinese mass market vehicles can embody:

- **Strong individuality** would be a theme that plays on the desire to stand out among other consumers in the world's most populous nation. This would play on the "individuality" theme, a current cultural trend, after decades of mandated conformity for many consumers.
- **Value for money** is a logical extension of the idea that in an emerging economy, there will be a substantial segment of customers who carefully assess each product attribute and place economic value on each. Chinese companies are well-known for their ability to reverse-engineer competitors' products and to make products that are "80 percent as good at 60 percent the cost." This concept could be extended into auto brand positioning.
- **Spaciousness** is a concept that likely has a different meaning in China than elsewhere, as people have become used to highly crowded public transportation such as buses, subways, and trains. Yet a positioning that offers somewhat more personal space, as measured by Chinese perceptions, could be a powerful differentiator, especially for cars positioned in the smaller-vehicle segments.
- **Flexibility** may be a differentiator outside of cities, where vehicles sometimes need to serve multiple purposes. By way of analogy, Haier, the Chinese white goods company, learned that rural customers of its washing machines used these devices for washing potatos as well as clothing and developed a product that would serve both purposes. Vehicles could also be designed for and positioned against analogous attributes, such as "dual-purpose."
- **Pragmatism** is the close cousin of **value for money**. Most Chinese consumers are inherently pragmatic about products, and will place value on only those features that they find to be useful and consistent with the ways they will actually use their vehicles.
- **Luxury** in China is as much an aspiration as it is a need for those who can truly afford luxury. Asian consumers in general, and many Chinese consumers in particular, have shown a much higher propensity to buy luxury products than Western consumers with similar disposable income. Luxury goods companies like Louis Vuitton can attest to this proclivity in the Far East. During the Chinese New Year, we see lavish sums of money being spent on decorations for the home and on luxury food products such as bird's nest specialities and shark fin soup, even among people of modest means. We can envision modestly priced vehicles, with touches of luxury.
- **Self-expression** will be a desire among many first-time vehicle owners in a land of truly masses of people. Beyond accessorizing, there may be a real opportunity to add enhanced options to even simple vehicles. Chinese car buyers desire that their vehicles fulfil representative functions for their relatives, friends, and the general public.

The Chinese Consumer: Unknown and Disloyal?

The brand core needs to be directed at carefully selected consumer groups and segments. However, not much is known about Chinese automotive consumers in detail. We know that the typical Chinese car buyer is between 30 and 45, male, and uses his car equally for work-related and non-work-related travel. Most of them are private buyers. They have generated their wealth within recent years and live in coastal cities in the eastern regions. Beyond these generic data, however, little is known about the demographics of Chinese car buyers. For instance, what about the legions of female car buyers? To what degree do women influence the decisions of the typical male buyer? And what about age and demographic segments that are unique to China, such as the car buyer who pools financial resources from parents and relatives in a purchase of a family-use vehicle?

What is known, however, is that Chinese consumers are still very open when selecting their new vehicles. They like to shop around and consider several brands when buying new vehicles. Brand loyalty is typically very high in Western markets, with around 80 percent of car owners considering the same brand for their new cars. In China, brand loyalty levels are currently at 10 percent or lower. Major factors driving low brand loyalty include the fact that most private consumers are still in the process of buying their first vehicles and therefore have no experience with brands. Also, the pre-owned vehicle market is just developing and therefore rating agencies that exist in other markets to estimate the value of used cars are only now beginning to start collecting data and drawing conclusions on specific vehicle performance and residual values. At least for now, this will provide an advantage for new entrants in the auto market or for brands that are trying to attract first-time or second-time buyers.

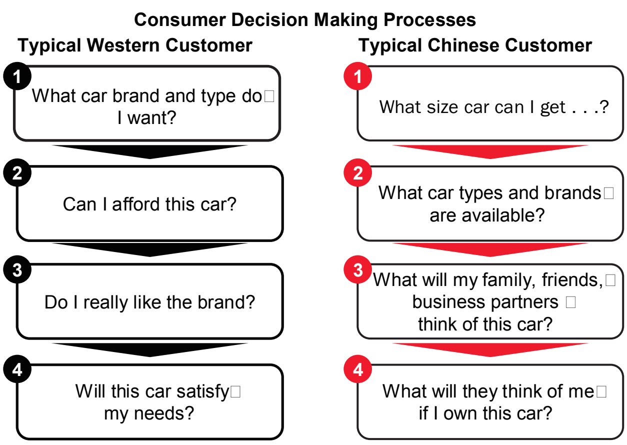
According to our research, Chinese consumers will make their purchase decisions based on a slightly different set of criteria than Western consumers, and will follow a different decision-making pattern.

Where to Brand Chinese Cars

China is a vast country, with regions that differ significantly in wealth, transportation infrastructure, and customer behaviour. Carmakers need to recognize the regional differences when deciding on the rollout of their branding strategies and dealership network coverage. Booz Allen research indicates that the Yangtze and Pearl River deltas will be regions with attractive growth potential and high car ownership. For Chinese carmakers with a potential mass market position, inland regions like Sichuan and Hebei, and emerging coastal provinces like Fujian will be additional attractive locations as customers there will be prone to a "value for money" brand proposition. From a city perspective, Chinese carmakers may have an advantage in promoting their brands and in setting up dealerships in second- and third-tier cities, while avoiding head-on competition in Beijing and Shanghai. These cities have a set of factors that make them attractive, including:

- High percentage of car ownership
- High percentage of aspirational, private buyers with significant wealth who will consider buying Chinese vehicles
- Less saturation of foreign brands, as the penetration of customers is still lower than in first-tier cities
- Lower average levels of disposable income suggests a preponderance of more value-conscious and lower-price-point buyers, against which Chinese brands will be relatively better positioned than most foreign brands (at least for now)

Exhibit 1
How Chinese decision making patterns differ from Western consumers



Source: Booz Allen Hamilton analysis

There are more than 100 of these second- and third-tier cities in China, representing an ample opportunity.

Branding Best Practices for Chinese Vehicle Manufacturers

When comparing best practices from mature markets with first attempts by Chinese carmakers to create their own independent brands, we would make the following set of directional recommendations:

- **Brand architecture.** Best practices from established VMs point to successful differentiation of corporate and product brands—for example, GM with Saturn, Opel and Saab, or Toyota with Scion and Lexus. Volume carmakers that compete in China are largely multi-brand companies. Volkswagen with VW and Skoda is another example. In our view, Chinese VMs should distinguish between their corporate names and their product brand names, and develop brand portfolios that distinguish their (potential entry) value brands from aspirational or premium brands.
- **Brand names.** Most established brand names are derived from either size (such as the Mini) or heritage (such as the Ford Mustang), or follow a certain logic. The latter can be numeric (such as A4 or A6) or evocative (such as Sonata or Elantra). We would advise Chinese VMs to establish a standard logic for their brand names; numeric names, in particular, are transparent, understandable, and easily neutral from a customer perspective.
- **Styling.** Vehicles within a brand generally share a common set of recognizable characteristics. For instance, Alfa Romeo and Audi cars have the same grilles, while BMWs have the same driveline configuration. Chinese VMs, too, should select a standard design feature for all of their vehicles to share, such as a grille or lights.

The growth of the Chinese auto market continues to outperform expectations in terms of speed of growth and the variety of new models in the market. Automotive brands are still in the process of being formed, but the window for action is rapidly closing and with it, the opportunity to establish winning brands. Some of the most famous auto brands in the world were formed very early in the history of the auto industry, and have changed little in character since then. The rewards for those who get it right early on have been enormous, underscoring the importance and value of investing the time and resources to think through this most essential issue.

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