McKinsey&Company

MCKINSEY CENTER FOR FUTURE MOBILITY

Savvy and sophisticated: Meet China's new car buyers

September 2017

Wouter Baan
Paul Gao
Arthur Wang
Daniel Zipser

September 2017

China auto consumer survey 2017

Savvy and sophisticated: Meet China's new car buyers

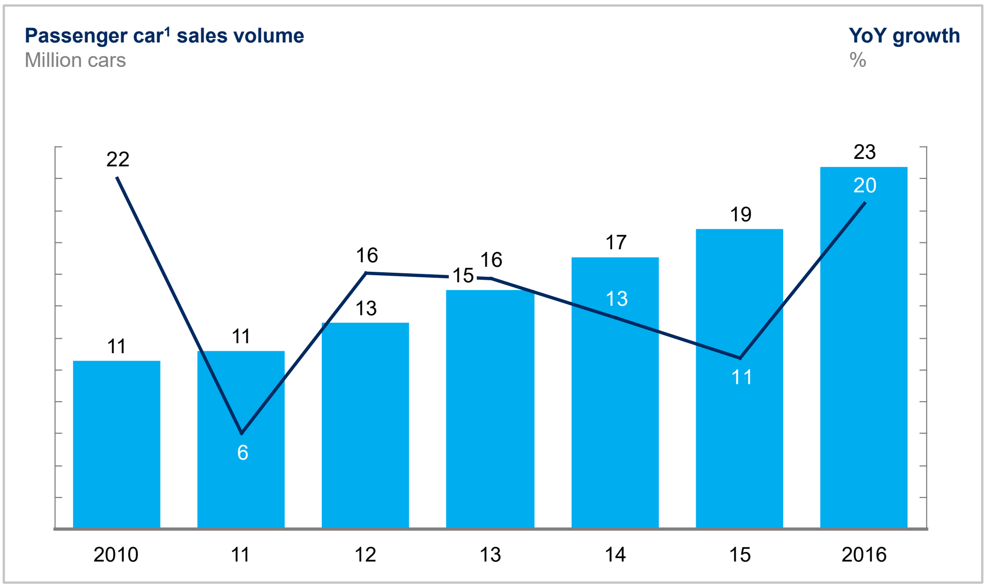
Wouter Baan
Paul Gao
Arthur Wang
Daniel Zipser

Introduction

After registering its lowest growth since 2011, China's automotive market rebounded strongly in 2016 (Exhibit 1). Car sales jumped 20 percent, nearly twice the rate of increase in 2015. Much of this vigorous expansion resulted from the country's temporary suspension of sales taxes for cars with small engines. Volatility continued in 2017: A large drop early in the year reflected

Exhibit 1

China's auto market rebounded to a 20% sales volume growth



1 Including sedan, MPV, SUV

SOURCE: McKinsey M-view

the impact of strong "pull ahead" sales in December 2016, as many consumers sought to take advantage of a lower sales tax rate before an increase took effect on January 1, 2017. However, sales growth eventually picked up again over the course of the year.

While the recent resurgence in sales represents one of the most dramatic shifts in China's automotive market, a variety of other factors are at play that will drive even more profound changes in the industry over the coming years. Perhaps the biggest of these changes involves the transformation taking place among car buyers. Increasingly savvy and sophisticated, today's auto buyers demand more digital features and are growing increasingly unhappy with the traditional dealer experience. The emergence of this more demanding segment of car buyers is reshaping the car industry.

To better understand China's car buyers, and how changes in consumer behavior will impact the future of the auto market, we conducted an extensive survey in July 2017 of over 5,800 auto buyers who purchased cars within the last year. These consumers came from 44 Tier-1 to -4 cities and seven counties, located in 19 key city clusters across China. Collectively, these clusters contribute 90 percent of China's urban GDP and contain half its population. In addition, this report reflects the latest forecasts from our proprietary China new car sales database (M-view), as well as insights from the McKinsey Global Institute.

Exploring China's huge market

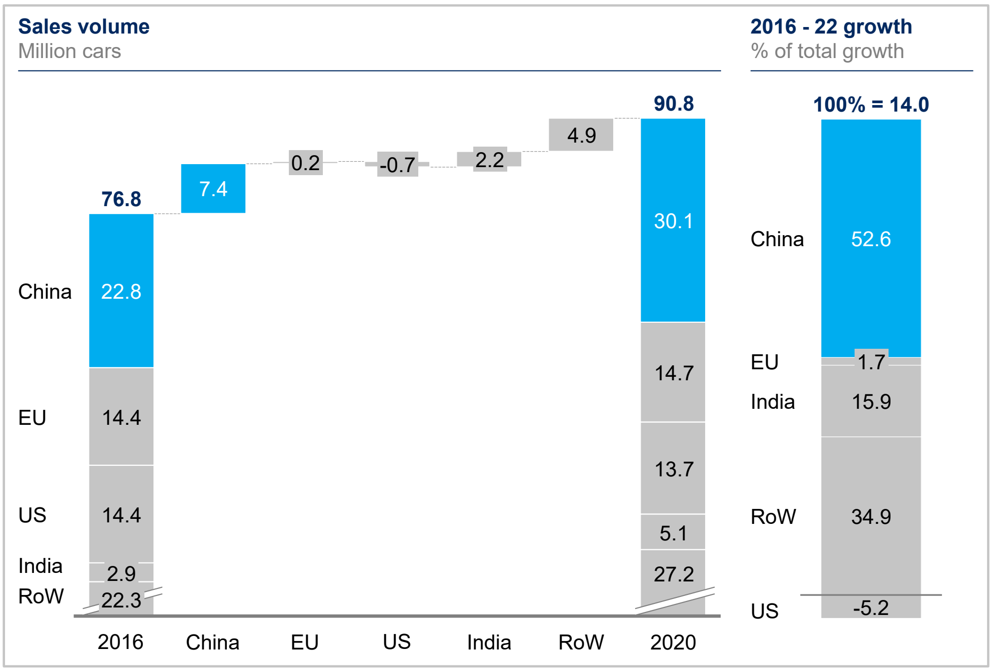
China's car market in 2016 closed with record-breaking sales of almost 23 million passenger vehicles. Our research reveals what's ahead for the world's largest, and still one of the fastest growing, car markets.

Continued dominance through 2022, but rules for winning will change

Despite its recent volatility, we expect the Chinese auto market to remain the global industry's primary growth engine (Exhibit 2).

Exhibit 2

China will contribute over half of global car sales growth through 2022



SOURCE: McKinsey M-view, IHS

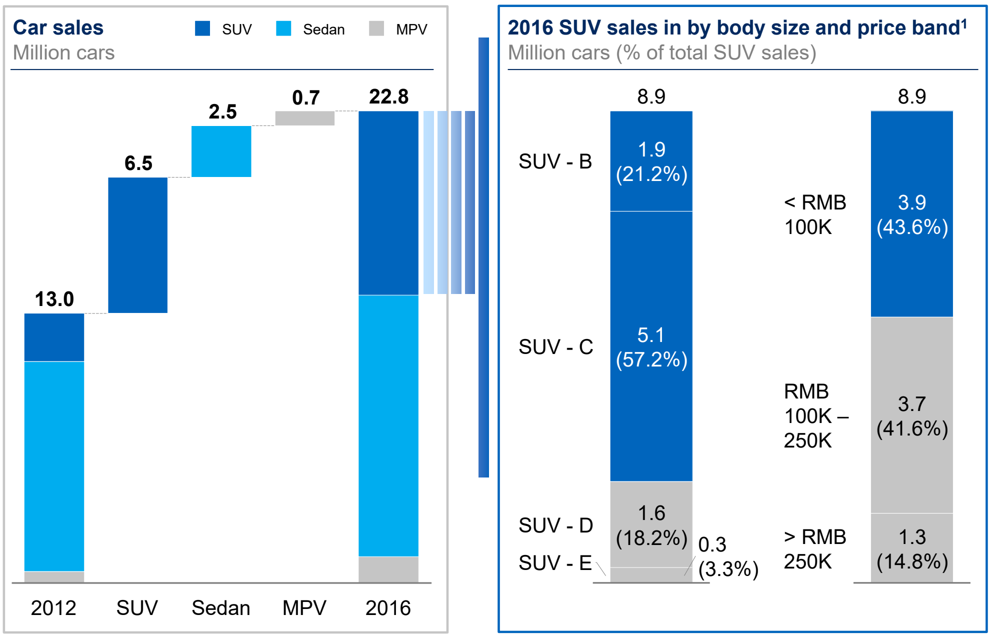
Although sales should increase by a modest-for-China 5 percent annual rate through 2022, this will equal 53 percent of the growth in the global car market – still a lower share than in the last five years, when China contributed 78 percent of global car sales growth. In contrast, the developed markets of the US and Europe will either contract or stagnate during the same period, with much of the remaining global growth coming from a fragmented set of emerging markets.

Sales growth sources: SUVs and the premium segments

SUV sales continue to dominate growth in China, and are expected to move beyond entry-level segments. In the last 4 years, the SUV segment accounted for 66% of total car sales growth. This was largely driven by small SUVs in the B and C segments, which last year accounted for 78 percent of SUV sales (Exhibit 3).

Exhibit 3

SUVs generate the most market growth, and continue to move upscale



1 Categorized by model based on entry level MSRP

SOURCE: McKinsey M-view

Chinese brands are the biggest winners in the entry-level SUV segment (priced between RMB 50,000 and 100,000), where they faced limited competition from international players. They captured an 89 percent share of this lower-price-tier market. Dominating this segment helped Chinese brands grow their combined total share (not including joint-venture brands) in the SUV market from 27 percent in 2012 to 48 percent in 2016.

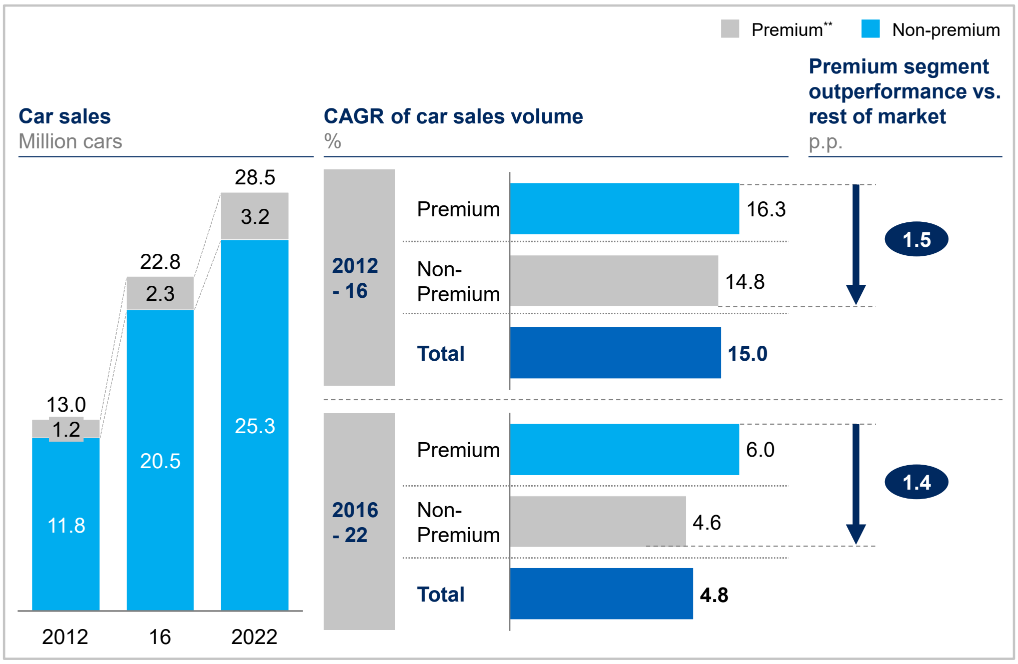
We expect SUVs to retain their strong appeal. This growth will occur across all SUV segments and price bands, with the entry-level SUV segment contributing "only" 44 percent of the total. This means that in 2022 one out of every two cars sold will be an SUV.

Premium on the rise: Like many other consumer categories in China, the move upscale to premium products is an ongoing trend in the car market. Our survey shows that 55 percent of respondents who replaced or complemented their existing cars in 2016 chose more expensive new ones. Also, although we found that around half of our respondents no longer think of cars as status symbols, more young people and those who bought expensive cars (vehicles costing over RMB 400,000) still consider cars status symbols compared to the average.

Premium brands* (see the full list of included brands in the endnote) continue to outpace the rest of the market. Moving forward, as the market slows from double- to single-digit growth, we expect that premium brands will continue to outpace the rest (Exhibit 4).

Exhibit 4

Premium segment is on the rise, continues to outpace the rest of market



SOURCE: McKinsey M-view

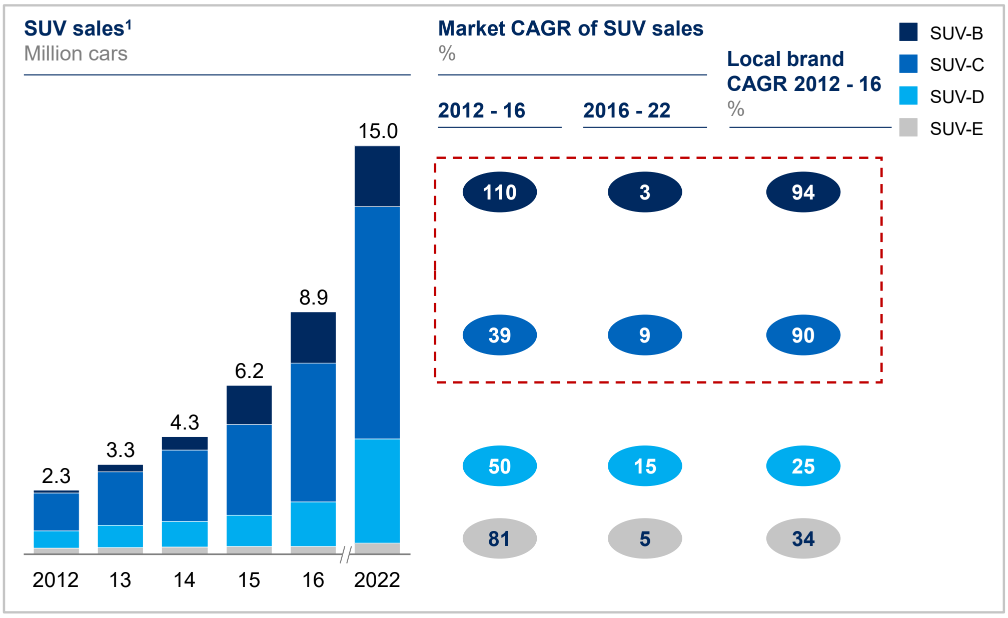
From a price segment perspective, cars costing more than RMB 250,000 should see sales expand at a 10.5 percent CAGR, while the rest increase just 4.1 percent a year. Support for this scenario comes from over half of our survey respondents, who say they plan to trade up to a more premium car for their next purchase (31 percent said they will look again based on the new brands and products trending at the time).

Entry-level SUV makers must grow beyond their segment

Entry-level SUVs have propelled local OEM growth, explaining 98 percent of their sales increase from 2012 to 2016. The overall B and C segment SUV markets grew by 110 percent and 39 percent a year, respectively, from 2012 to 2016. In comparison, local brands in these segments grew by 94 percent and 90 percent, respectively, during the same period (Exhibit 5).

Exhibit 5

Entry-level SUVs provide growth for local brands, but face challenges as the market shifts upscale



1 SUB-B: sub-compact SUV, usual size is 3,700 – 4,000 mm; SUV-C: compact SUV, usual size is 3,800 – 4,600 mm; SUV-D: standard SUV, usual size is 4,500 – 5,100 mm; SUV-E: luxury/full-size SUV, usual size > 4,800 mm

SOURCE: McKinsey M-view, IHS

SUV market increasingly crowded: While a recent attractive source of growth, the segment is becoming an increasingly crowded battleground among brands. In 2015 and 2016, the market saw the launch of 16 and 26 new SUV models, respectively, and another 32 models (not including new generations) during the first half of 2017. Compare that to an average of 12 models from 2011 to 2014, and it becomes clear why the impact on margins has been significant. One of the leading local players, Great Wall, announced a 50 percent drop in net profit, falling from 12 percent in 2016 to 6 percent in the first half of 2017. What's more, local OEMs saw little success in other segments. For instance, they lost share in the sedan segment, dropping from 22 percent in 2012 to 16 percent in 2016.

To avoid fierce price wars in this lower-price market segment, players are launching more premium SUVs (or in the case of Great Wall, an entirely new, more premium brand) to improve margins. However, it remains too early to tell whether such actions will convince car buyers to buy these brands in a segment filled with well-established international brands (discussed below).

Local brand boosters: The biggest fans of local automakers (meaning they consider them either more reliable than or on a par with foreign brands) are from Northern China, where 43 percent of respondents make this statement, compared with 33 percent in other regions. Nationwide, 38 percent of the mass-market middle class express good opinions of local brands versus 26 percent in the affluent segment. Also, 39 percent of respondents in the customer segment characterized as "non-digitally savvy" speak positively about Chinese brands, while only 25 percent in the "digitally savvy"** (see definition in endnote) segment say the same.

One thing on which consumers across all dimensions agree is the lack of upscale strength among local brands. Only 8 percent say local players have aspirational brands they want to buy next. Clearly, whether local players can replicate their current success with entry-level SUVs across other segments remains an open question.

Looking forward, Chinese brands may also increase their presence in the electric vehicle (EV) segment as more car buyers recognize that Chinese carmakers produce acceptable EVs. The domestic industry's growing production share of EVs, from 18 percent in 2016 to 23 percent in 2017, provides proof of this increasing awareness.

Consumer trends: less loyal, but more connected

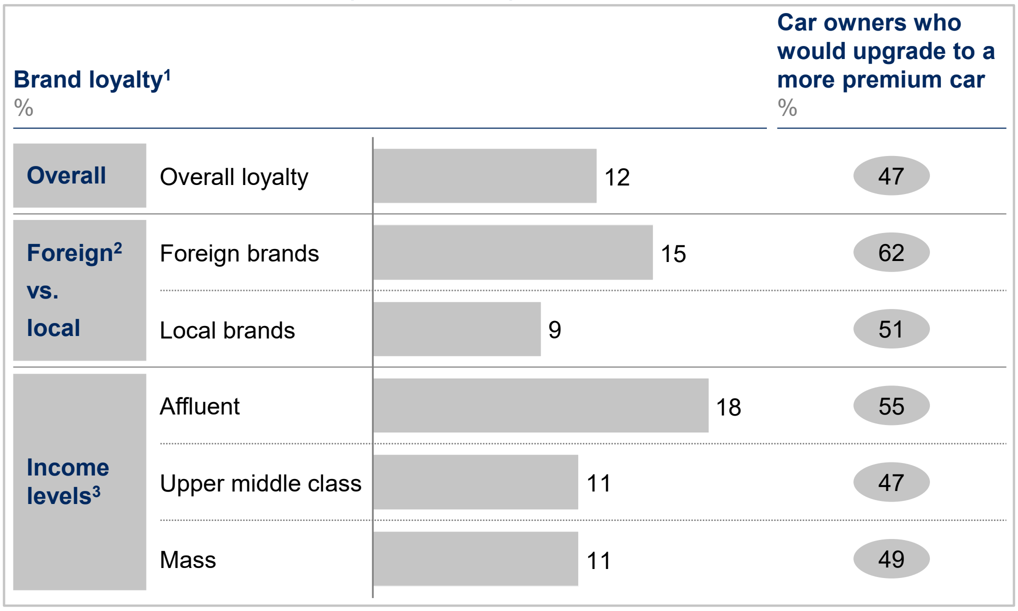
Our survey of China's car buyers shows declining repurchasing loyalty (from rates already lower than global findings) but growing demand for digital features such as connectivity. A new generation of Chinese car buyers has goals and desires different from those of previous respondents, and fewer survey takers express satisfaction with the dealer experience.

Falling loyalty compels automakers to rethink brand strategies

Our survey indicates that only 12 percent of recent car buyers want to buy the same brand the next time (Exhibit 6). While China's car buyers have always been fickle regarding car brands, this represents a steep decline from the 19 percent registered in last year's survey.

Exhibit 6

Consumer loyalty remains relatively low across segments, as nearly half of consumers tend to trade up to a more premium brand



1 Percentage of car owners who prefer to buy their current brand as their next car
2 An average of Mercedes, Audi, BMW, Volkswagen, Buick, Toyota, Nissan and Chevrolet
3 Mass: monthly household income of RMB 4,300 to 12,000; upper middle class: monthly household income of RMB12,000 to 25,000; affluent: monthly household income above RMB 25,000

SOURCE: McKinsey China Auto Consumer Survey 2017

Nevertheless, loyalty among international car owners is higher than that for local ones. For example, 15 percent stated they will buy the same international brand next time, compared to

9 percent of local car owners. Also, our research suggests consumers have the highest loyalty to premium brands such as Mercedes, Audi, and BMW, although the ratings are still only 18 to 23 percent. Potential explanations for this include the likelihood of trading up (43 percent of the respondents plan to buy a more premium brand), or simply that consumers value a specific offering at a given moment.

From a consumer segment perspective, younger (below 34 years), more affluent consumers exhibit the most loyalty, with 18 percent choosing to purchase the same brand compared to 11 percent for other segments. Whatever the reason, mainstream brands must rethink their strategies for capturing the imagination of potential buyers. Conversely, it opens the door for ambitious players with growth plans.

Next generation of car buyers is transforming the market

McKinsey's survey offers a glimpse of the next generation of China's car buyers, who, while heavily interested in connectivity, appear less convinced of the need for a personal car. Insights include:

- **Cars are no longer essential:** Fifty-two percent can imagine life without a car, 36 percent agree it's not as important to own a car as it was in the past, and 38 percent are willing to give up their cars if they receive free shared mobility in return.

- **Staying connected:** Asked about their satisfaction with current entertainment and navigation features and services, 10 percent more young buyers than other groups considered their current in-car systems outdated, and 83 percent of them found it "appealing" to have phone-car synchronization.

- **More shared mobility:** Millennials are twice as likely to use car-sharing services on a weekly basis compared to older generations (12 percent versus 6 percent) and are more likely to use peer-to-peer (P2P) car rental services (14 percent versus 9 percent). Compared to 22 percent of older drivers who are unwilling to share their cars on P2P car lending platforms, only 11 percent of millennials say the same.

- **E-commerce on the rise:** More of the next generation (23 percent versus 10 percent of those over 24 years old) are using online channels to make purchases.

- **Lower trust regarding commercials:** Young consumers show slightly lower trust (3 to 8 percentage points less than older segments) regarding information sources like dealer call centers, TV commercials, newspaper, and road shows.

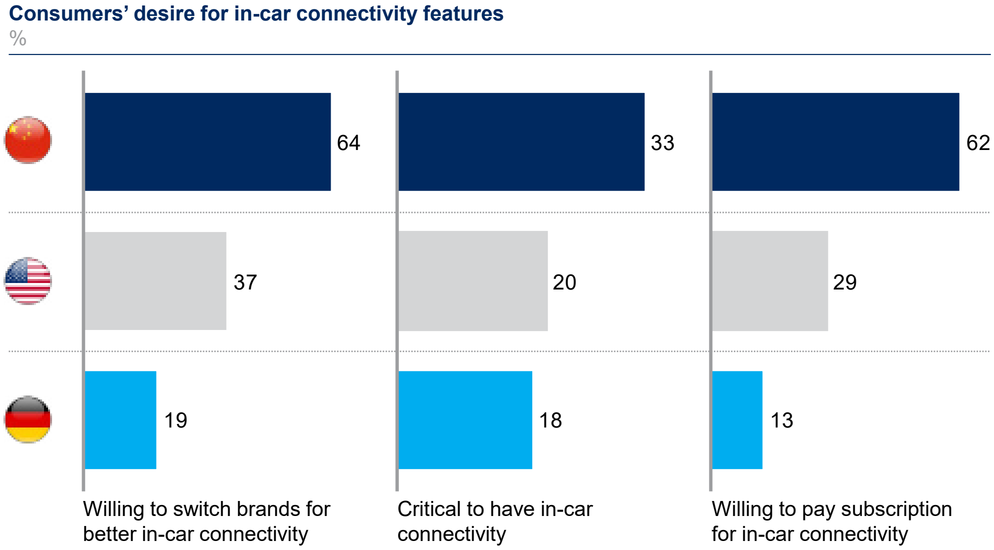
Big appetite for in-car connectivity, but many hungry for better existing features

Consumers are difficult to please when it comes to in-car connectivity services. They want in-car services, and will switch car brands to get what they seek. Connectivity is a must-have feature, and they are more willing to pay subscriptions for content than customers in the US or Germany.

Dialing in on car services: Seventy-nine percent of consumers see a need for in-car services. They are, however, picky regarding what they want. Sixty-four percent of consumers in China are willing to switch brands if their requirements go unmet – more than the 37 percent in the US and 19 percent in Germany (Exhibit 7).

Exhibit 7

Connectivity: Chinese consumers have high appetite for in-car connectivity features



SOURCE: McKinsey Global Connectivity Survey 2016, 2017

While half of respondents express satisfaction with their in-car entertainment and navigation services, the other half view these features as outdated with limited functionality. Smartphones seem to set the expectations bar when it comes to functionality and ease of use. Consumers also see a need to have their in-car and other mobile experiences at least partially harmonized: half of all consumers recognize the benefits of smooth synchronization between their phone apps and car services.

Demand for in-car connectivity is much higher in China: A third of the respondents say it is critical to have in-car connectivity, compared to 20 percent in the US and 18 percent in Germany. Only 11 percent of respondents are not willing to pay extra for an in-car connectivity system, compared to 43 percent in Germany and 30 percent in US.

Subscriptions seem to have potential as new revenue stream: Sixty-two percent of customers in China are willing to pay subscriptions, significantly more than the 29 percent in the US and 13 percent in Germany. An increasing appetite to pay for content is also emerging in other digital areas, such as online video, where contrary to many predictions, people are willing to pay for high-quality content. For example, iQIYI, an online video platform, has over 20 million subscribers today, up from virtually none three years ago.

Downstream trouble ahead?

Consumer expectations continue to rise regarding the retail experience. Increased consumer sophistication – fewer first-time buyers and increasing digital savviness in all aspects of their lives – is raising people's expectations. Although consumers say they visit 4S[1] stores multiple times before buying a car, only 49 percent express satisfaction with this experience. The main sticking points include low information transparency (for example, on options, features, and prices), time-consuming purchases and other processes, long travel times to the closest 4S store, and relatively low tech and outdated service offerings.

Automakers could address most of these factors by applying digital solutions. Although online channels play a leading role during the initial stages of the consumer journey, automotive players have not been able to develop an integrated online-offline journey. The integration should start from linking social media, offline activities, and the consumers' personal circles of friends, and can then be rolled out to all dealers.

Automakers could benefit from the trust that consumers have in their website. What's more, while customers may express dissatisfaction with offline dealers and services, these facilities won't disappear in the foreseeable future. In fact, 87 percent of car buyers value the expertise and aftersales service offered by dealers. The key factors valued by buyers visiting 4S stores include the one-on-one dedicated salesperson experience, the ability to explore the store freely, and having desired car configurations for test drives. By integrating these and other services into a seamless online-offline journey, automakers could help 4S dealers improve their differentiation, versus both competing brands and emerging channels.

Our survey reveals an urgency to act now as far as integrating online and offline elements of the retail experience. This holds true for both brands and 4S dealers to avoid losing direct contact with the customer or even losing sales. For example, increasing numbers of car buyers are making purchases online. In 2016, customers purchased 5 percent of vehicles online compared to 1 percent in 2014 (one caveat: in this case, online still means that customers close deals for these vehicles via nearby 4S stores). The shift to online could accelerate strongly, however, since buyers in the 18 to 24 age range are almost twice as likely to purchase online as older consumers. On the supply side, digital players are exploring potential roles in the industry. For example, auto vertical Autohome has already organized two virtual car shows in 2017 collaborating with around 30 brands.

Online financing companies make headway

Financing has played a key role supporting car sales in recent years. About 30 percent of overall buyers use financing when purchasing a car.

Although traditional players like banks and OEM financing companies dominate, online financing companies, typically supported by venture capital firms, banks, and sometimes leading Chinese Internet companies, are gaining share. Currently, 3 percent of those surveyed report receiving a car loan from these sources.

Residents of Tier-1 and -2 cities are five times as likely to shop at and use online financial companies compared to other car buyers. The reasons consumers choose these sources include their (perceived) higher acceptance rates, lower loan costs and more flexible and attractive loan terms. Players are attempting to differentiate themselves by moving beyond competing on price alone. For example, WeBank and Xin.com partnered to provide financing

---

1 4S stores refers to the four services provided by auto dealers: sales, spare parts, service, and surveys.

for used car buyers, with novel programs such as guaranteed returns in 15 days, financing approval in an hour, and the ability to select custom payment schemes. Such schemes can include no payments for the first two years, a low annual percentage rate (APR), or a car trade-in option after two years.

Although online financing is becoming more attractive, 97 percent of financing buyers still choose traditional providers. Our survey indicates that this is simply due to the perceived convenience of offline financing, and that buyers prefer to finance from the dealer from which they bought the car. The recent rise in online sales could, however, erode this advantage.

Used cars sales grow

Although the Chinese used car market remains immature compared to other major car markets, used car sales continue to grow. Top reasons for considering a used car include lower cost and the chance to buy a better model and brand for the same price. Those who did not consider buying used cars indicated their concerns centered primarily on the vehicle's history with previous owners and potential safety issues. People that bought used cars focused more on their value-for-money aspect in 2017 compared to 2016, when they typically sought only a low cost. What's more, concerns for not considering used cars have dropped overall compared to 2016.

As we mentioned last year in our report, new entrants like renrenche.com and xin.com – second-hand car platforms – are trying to build trust in used cars among consumers, which seems to be paying off. However, we don't see a higher interest among younger car buyers; something we would have expected. Also, we think that car brands can play a more important role by having more proactive trade-in programs to stimulate new cars sales while expanding the pool of attractive, younger vehicles on the market.

Electric vehicle demand centered in restricted license cities

China is now the largest market for new energy vehicles (NEVs) in the world. However, demand is still highly concentrated and regulatory driven. The cities in China with license plate restrictions for ICE (internal combustion engine)-powered cars account for about 60 percent of the national NEV sales (while only for about 10 to 15 percent of ICE sales). Although we expected to see an increase in interest in purchasing a NEV, our results show that interest remained flat at about one out of five car buyers expressing interest.

Buyers exhibit limited preference regarding the type of EV they would purchase, with about half considering both battery-electric vehicles (BEVs) and plug-in hybrid-electric vehicles (PHEVs).

Our survey also shows a positive correlation between a consumer's household income and his or her willingness to consider and purchase an EV. Affluent consumers with incomes that exceed RMB 25,000 a month are three times more likely to purchase an EV than consumers in the mass middle class with incomes in the RMB 4,000 to 12,000 per month range.

Among current EV owners, 78 percent express satisfaction with their vehicles, slightly more than the 69 percent in 2016, and 63 percent would recommend them to others. The top drivers of EV satisfaction identified by consumers include exemptions from "no drive days" and license restrictions, cost savings for fuel, and free use of city-wide charging service platforms.

Top reasons for not buying EVs have switched from complicated issues such as a scarcity of charging locations and high pricing in 2016, to concerns in 2017 about the EV's quality and safety, and a lengthy charging process. This indicates that the investments in charging infrastructure and its higher visibility are starting to work. Now it is up to the car brands to deliver attractive, high-quality models. One reason mentioned to further support sales is that more than half of the car owners would consider purchasing an EV if the driving range increased to 400 kilometers or if the prices dropped to match those of ICE models.

Although infrastructure is less of a concern for new buyers than in the past, 23 percent of current EV owners would still like to see more charging stations. About one-third of EV owners lack their own charging infrastructure, with 38 percent of them stating that their residences do not allow the installation of charging stations. Building a public charging network could be a solution for this, since 67 percent of people would be interested in a subscription-based charging service and 59 percent of people would be interested in a pay-as-you-go charging service.

Looking further ahead: autonomous driving shift perceptions

Although not being available in the market yet, we also tested consumer thinking around autonomous driving. Overall, consumers are excited about and have faith in autonomous cars. Over 60 percent of survey respondents believe autonomous cars will transport families in the future, compared to 43 percent in the US and 31 percent in Germany. Our survey shows that 61 percent think that car OEMs are expected to have the best autonomous driving technology, with two-thirds of these respondents having a preference for foreign OEMs. Surprisingly only 12 percent expect technology players such as Baidu to develop the leading technology. This lead nearly matches the 38 percent of ICE car buyers that believe foreign OEMs are more reliable than local ones, and likely reflects the same thinking. However, when it comes to operating an autonomous fleet, many respondents prefer parties outside of the traditional automotive industry. One-third of respondents say car OEMs enjoy the best positioning, while 26 percent and 15 percent, respectively, prefer the government or new mobility players.

■ ■ ■

China will remain a must-win market for car brands in the foreseeable future. As Chinese consumers continue to become more sophisticated, automakers must reinvent their success formulas to surprise and delight them. That means delivering leading-edge connectivity options, pursuing digital innovations, participating in the electric vehicle space, and taking steps in the burgeoning used-car market. With increasing competition from Chinese brands, digital players, and shared mobility companies, no traditional automotive player can afford to put off the substantial actions they should take today. Yesterday's "easy" growth in China is a memory; tomorrow's success will require a different set of skills and ideas.

Wouter Baan is an Associate Partner in the Beijing office, **Paul Gao** is a Senior Partner in McKinsey's Hong Kong office, **Arthur Wang** is a Partner in the Hong Kong office, and **Daniel Zipser** is a Senior Partner in McKinsey's Shanghai office.

The authors wish to thank Cherie Zhang, Constance Zhu, Glenn Leibowitz, Hongming Chen, Peter Li, Rachel Jin, Tony Zhou, Wendy Chen, and Zhicheng Su for their contributions to this article.

About the survey

This report is based on an extensive survey of China's recent auto buyers.

- This survey was conducted online in July 2017.
- The survey sample consisted of 5,832 respondents, divided evenly among five geographic categories (Tier-1 cities, Tier-2 cities, Tier-3 cities, Tier-4 cities, and rural areas). The respondents also represent a wide range of vehicle types, age groups, incomes, and Internet-use levels.
- The survey included deep dives into consumer attitudes, vehicle preferences, shopping habits, and aftermarket services.

* For the purposes of this report, premium brands are: Acura, Alfa Romeo, Aston Martin, Audi, Bentley, BMW, Cadillac, Faraday Future, Ferrari, Fiat, Genesis, GLM, Hongqi, Hummer, Infiniti, Jaguar, Karma Automotive, Lamborghini, Land Rover, Lexus, Lincoln, Lotus, Lucid, Maserati, Maybach, McLaren, Mercedes-Benz, Mini, Porsche, Rolls-Royce, Saab, Smart, Tesla, Volkswagen, Volvo

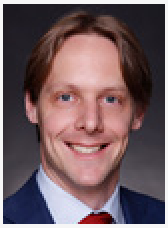
** The "digitally savvy" group refers to the samples completing the survey online while "non-digitally savvy" group refers to those finishing it offline.

About the McKinsey Center for Future Mobility®

The McKinsey Center for Future Mobility was created to help business leaders and policy makers come to terms with a future that is increasingly autonomous, connected, electrified, and shared. Based in four global hubs (Beijing, Detroit, Munich, and Silicon Valley), our forward thinking and integrated perspective, industry expertise, proprietary research, and global convening power gives us a unique combination of assets to help clients navigate the mobility revolution.

For more information, visit www.mckinsey.com/mcfm

Authors



Wouter Baan

Associate Partner
Beijing
wouter_baan@mckinsey.com

Paul Gao

Senior Partner
Hong Kong
paul_gao@mckinsey.com

Arthur Wang

Partner
Hong Kong
arthur_wang@mckinsey.com

Daniel Zipser

Senior Partner
Shanghai
daniel_zipser@mckinsey.com

September 2017

Design contact: GCO NewMedia
www.mckinseychina.com