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Potential Impact of Anti-trust Intervention on Automotive Business Models

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Draft*

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strategy&
Formerly Booz & Company

pwc

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Automotive Anti-trust Intervention and Its Potential Impacts

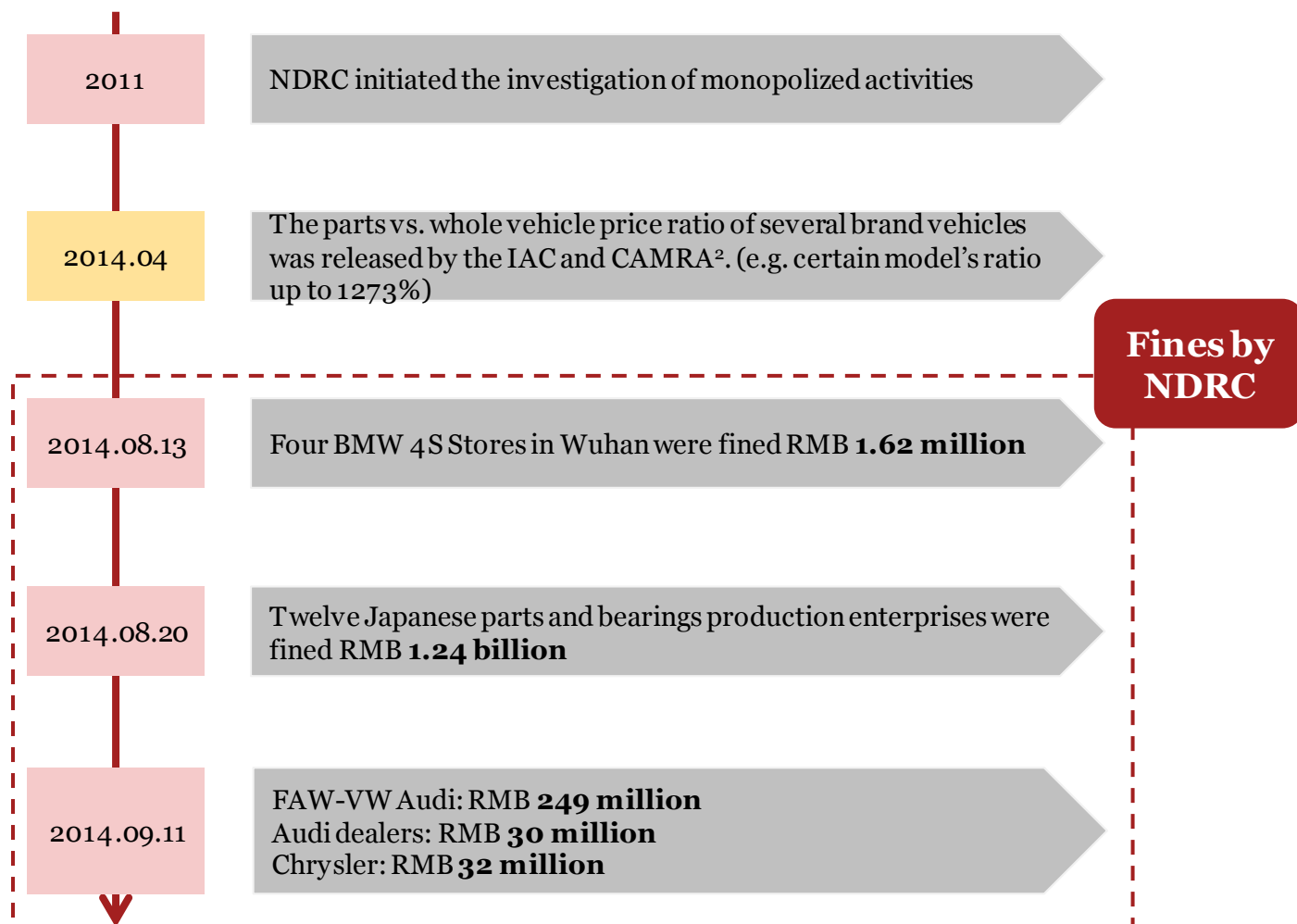
- Market survey (preliminary results from 30+ CEO/CFOs interviews)

1

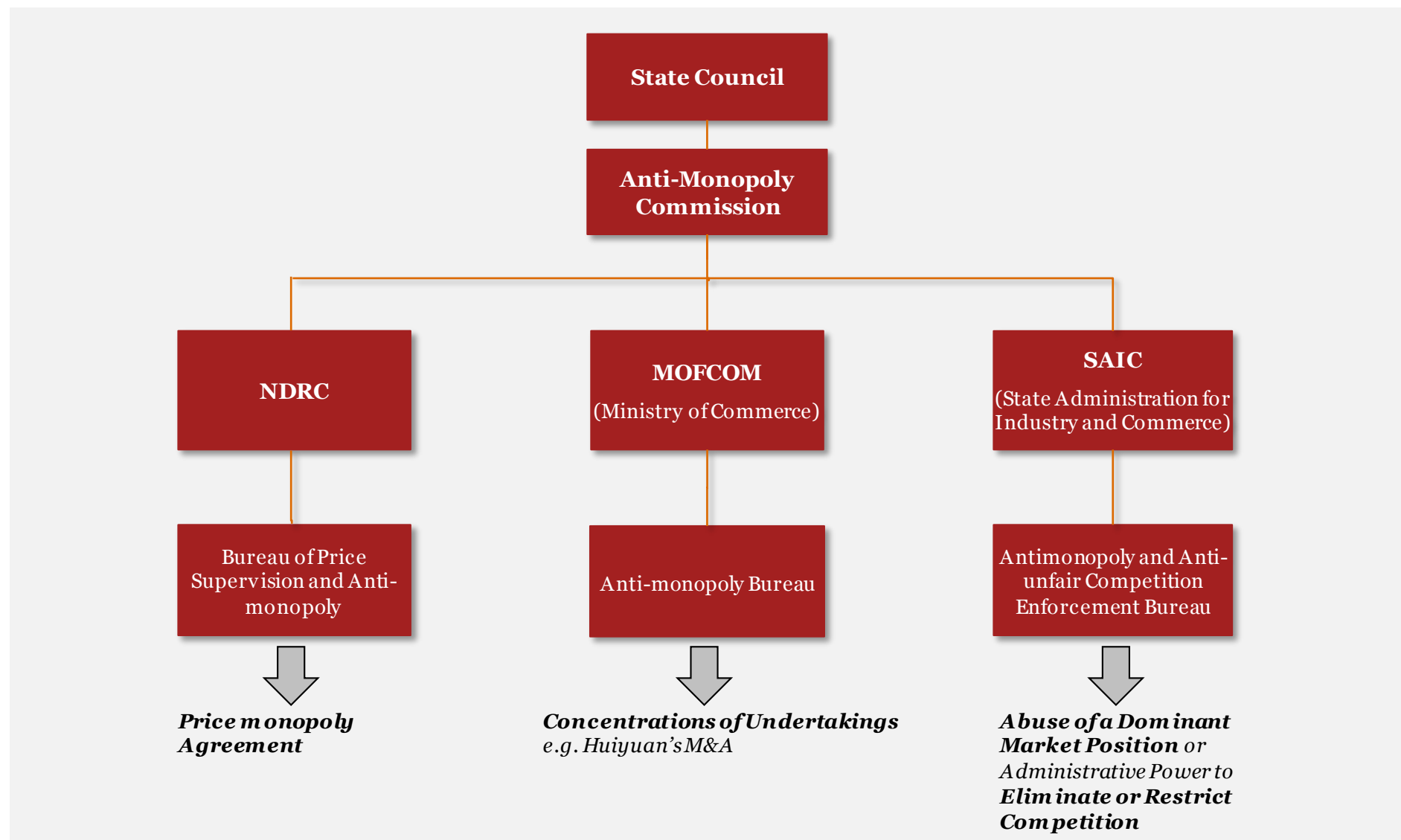
Background

Consumers and media have been complaining about the high prices for luxury cars and aftersales maintenance

NDRC¹ aims to establish a mature and freely competitive auto market and protect consumers' interests and rights



Chinese Anti-trust Authorities



Suspected Monopolized Activities

New Car Sales

After-sales Service

Horizontal

Agreement among different OEMs:

- Fix or adjust the selling price of new cars (incl. range of price changes, processing fees and discounts, etc.)
- Limit the amount of car production and sales
- Divide up sales market or raw-material-purchasing market
- Boycott trades

Agreement among different parts companies:

- Fix or adjust the selling price of parts
- Limit the amount of parts production and sales
- Divide up sales market or raw-material-purchasing market
- Boycott trades

Vertical (Price Monopoly)

- Set the floor price / fix price for new cars

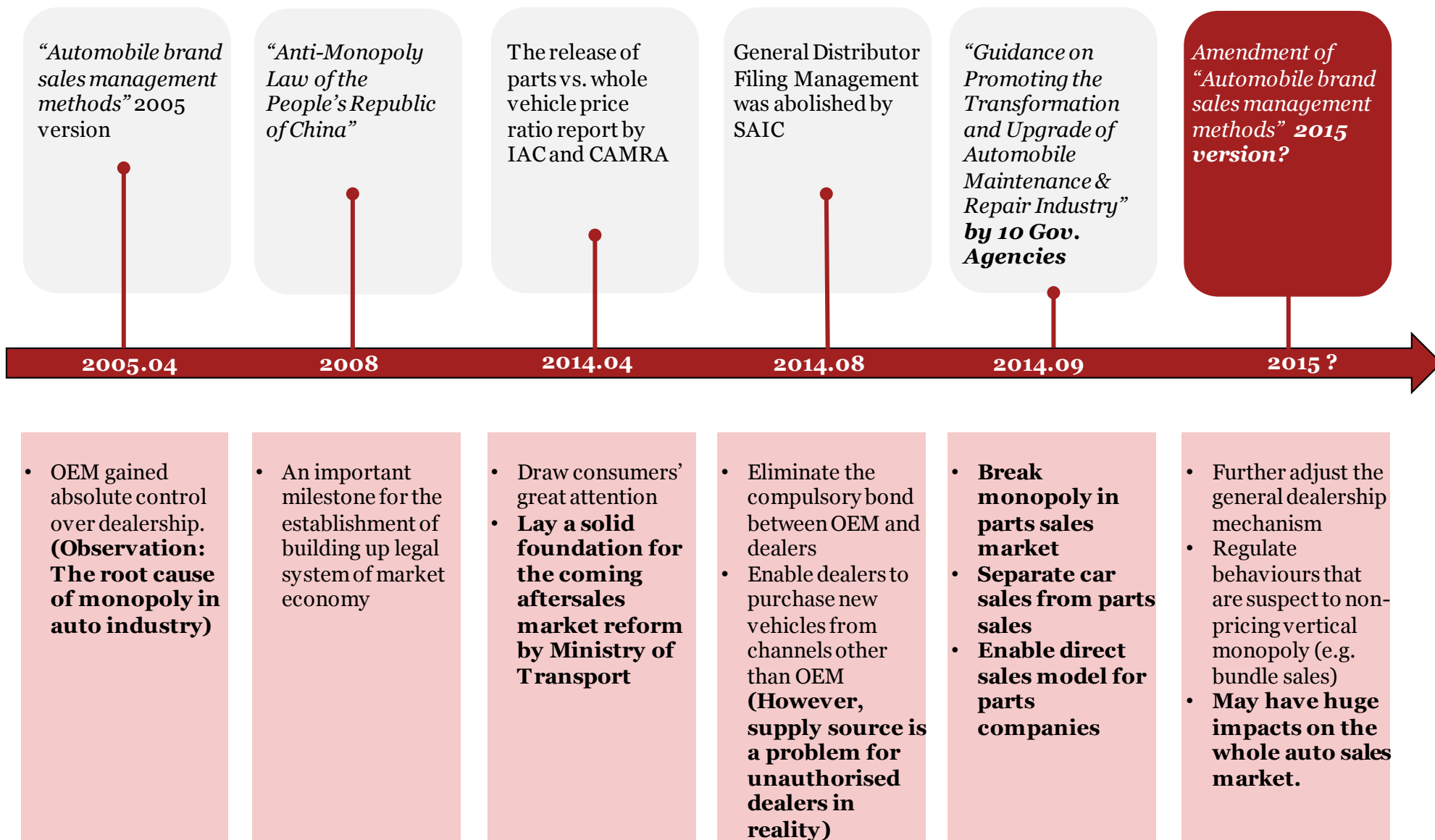
- Set the floor price / fix price for parts, maintenance and repair service

Vertical (Non-price Monopoly - Abuse of Dominant Market Position)

- Require dealers to purchase new cars from OEM exclusively
- Restrict dealers to sell cars within the region
- Bundle sales
- Unwilling additional orders. E.g. year-end
- Impose unreasonable requirements, incl. pledged capital, sharing advertising costs etc.
- Reject trades with dealers or ban dealers from transferring cars

- Ban parts suppliers from selling parts directly to dealers, maintenance stores or consumers
- Refuse to provide after-sales service to cars purchased through parallel imports
- Impose other unreasonable requirements

Anti-monopoly's Impact on the Market – Policy



Anti-Trust Intervention Survey

- preliminary results from 30+ CEO/CFOs interviews

Objective:

- To interpret the impacts of Chinese automotive anti-trust intervention
- To discuss the possible action OEM, dealers, parts companies may take to cope with the market change

Approach:

- Interviews with key decision makers along the automotive value chain (e.g. OEM, Dealers and parts companies)
- Key questions:
 - What do you think will be the mid and long term impact of the government antitrust intervention on the auto sector and your company?
 - Which short or long term initiatives are you considering in response to the intervention?
 - Do you expect further regulatory pressure / interventions and if so in which areas?



Survey results from interviews with OEMs

Immediate-/Short-term Impacts (1-2 years)

Business operation perspective

- **Price reduction** of whole vehicles, especially luxury and imported cars
- **Price reduction** of OE parts
- **Disclosure maintenance information to aftersales market**

Financial perspective

- **Profit loss from parts sales**
- For whole vehicle sales, as many OEMs still haven't changed wholesales price, its financial impacts still need to be further assessed.

Middle-/Long-term Impacts (2 years+)

OEMs' dominant control over dealers and aftersales market may be slightly and gradually changed.

- **Dealer management mechanism may be adjusted**, business terms and practices against anti-trust laws will be terminated, new incentive mechanism needs to be introduced.
- **Parallel imports may be allowed**
- **OEM will suffer revenue/profit loss due to open loop of parts**
 - ✓ Less profit for selling parts
 - ✓ 4S stores will switch to public market to buy decoration /beautification parts and other homogenous parts directly sold by parts companies.

Potential Action Plans

Short term:

- Response to Anti-trust Intervention
 - ✓ Reduce price for whole vehicles and parts
 - ✓ Disclose maintenance info
 - ✓ **Price transferring**
 - ✓ **Dealer management compliance review & training**

Middle to long term:

- Open loop of the parts market
 - ✓ Allow dealers to resell OE parts.
 - ✓ "Allow" parts company to operate direct sales models
 - ✓ Develop 2nd OE parts
 - ✓ Develop branded quick service chains
- **Dealer management transformation**
 - ✓ Adjust KPI steering concept
 - ✓ Adjust incentive mechanism

Survey results from interviews with Auto Dealers

Immediate-/Short-term Impacts (1-2 years)

Business operation perspective

- **Impact on whole vehicles:**
price for luxury cars will decrease and consumers will expect discount for all models.
- **Reduce maintenance and repair fee** (e.g. 10%-20% off on parts and 20% off on hour charges)
- **Many dealers would expect no immediate impacts as well** (due to “wait-and-see” attitude)

Financial perspective

- **Profit loss** from both high-end whole vehicle sales and maintenance & repair business

Middle-/Long-term Impacts (2 years+)

- **Market share and revenue loss for parts and maintenance business:**
 - ✓ IAM players will grasp more shares from 4S stores under parts open loop (less must-buy from OEM - furniture, carpets, etc.)
 - ✓ Cost reduction from parts sourcing, but also lower parts pricing
- **More differentiated positioning between 4S stores and IAM players**
 - ✓ 4S stores will remain significant technical advantages over IAM services and repair shops to keep their customers (OEM will incline to provide more technical support to 4S stores)
 - ✓ 4S stores will retain customers with good quality, services and technical advantages
- Price reduction in 4S stores will drive customers back to 4S stores

Potential Action Plans

- **More promotion and discount** on repair/ parts to attract customers
- **Provide more value-adding services.** E.g. home delivery
- **Buy more non-OE high quality parts from aftersales market**
- Big dealer group will plan on **centralized bodywork / repair shops, multi-brands repair shops**
- Consider building up **multi-brands dealer shop**
- **Whole vehicle sales and aftersales may be gradually separated.** Showroom Vs. repair chains
- Training for preventing monopoly accusations

Survey results from interviews with Parts Suppliers

Immediate-/Short-term Impacts (1-2 years)

- Pressures from OEMs to reduce OE parts price
- Increasing demand of homogenous parts from IAM shops
 - ✓ Under open loop, retail format will be changed - 4S retail format will not be a prevalent format, more IAM formats will emerge

Middle-/Long-term Impacts (2 years+)

- **May consider transform business model**
 - ✓ Many parts company already directly sales parts to IAM shops etc. for many years; It is a opportunity for them and other parts companies to further explore the market
- **Impacts form internet companies**
 - ✓ O2O starts up entered into the market by offering different services. E.g. onsite maintenance by kalading.com

Potential Action Plans

- Adjust business model
 - ✓ business case analysis
 - ✓ business plan
- Reform sales channels
 - ✓ Direct sales to dealers and IAM shops
 - ✓ Open online shops
 - ✓ Open direct sales shops
- **Re-design quality assurance system and process**
- **Cooperation with OEMs or others to develop the business**
 - ✓ **E.g. Set up a JV business**

Potential Impacts on Car Maintenance Market (1)

Car maintenance market enjoys a large scale and high growth rate

Types

- 4S Store
- Repair Plant
- Maintenance Store
- Auto Parts Center

480,000 in total

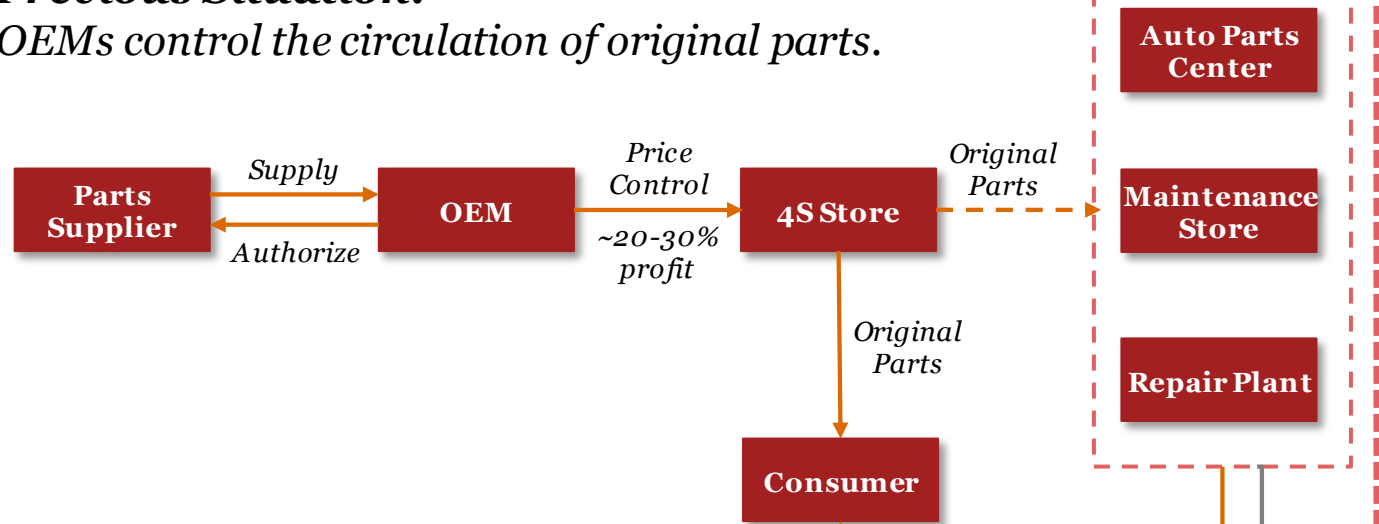
No. of Employees:
4 million

Annual Maintenance Services: **RMB 3.3 trillion**

Annual Output:
RMB 500 billion

Previous Situation:

OEMs control the circulation of original parts.



Abnormal Circulation Channels of Original Parts for non-4s stores.

1. **Employees** at OEM secretly sell parts e.g. from plants or storage
2. **Parts suppliers** sell some parts behind OEM
3. **Dealers** resell some of the original parts
4. Parts removed from **test cars** are also on sale etc.

Potential Impacts on Car Maintenance Market (2)

Eliminate auto monopoly and create new market opportunities

Supply by parts suppliers; and Resell by dealers

Supply channels for original parts are expanded

OEM disclose maintenance information to public; Maintenance service acquired in non-4S Stores are acknowledged and guaranteed with the 3R (Sanbao) policy

More maintenance choices for consumers

Homogeneous parts are acknowledged

Homogeneous parts market booms and reduces the average price of spare parts

Further development of the market:

The annual output is expected to increase from RMB 500 billion at present to 1 trillion in 2020.

Key Strategic Considerations

1

OEMs:

- Which parts could be opened to aftersales market? (IP issue)
- How to manage/monitor parts and maintenance business of dealer shops/direct-sale stores?
- Cooperation opportunities with others? E.g. set up JV with parts companies

2

Parts Company:

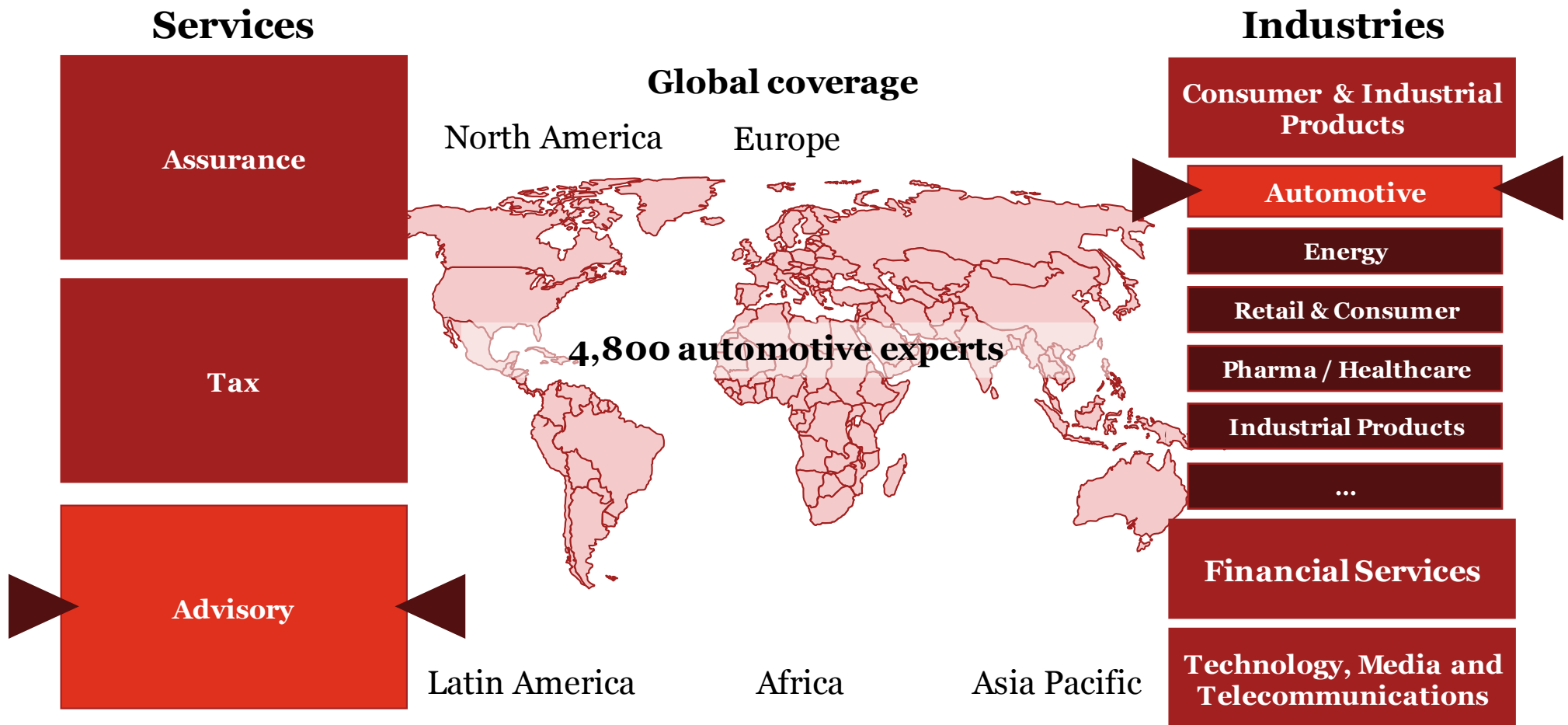
- How to transform the business model ? E.g. more direct sales and online channels ?
- How to continue to maintain a strategic partnership with OEMs? How to balance the new channels with old OEM channels?
- Cooperation opportunities with OEMs?
- How to take first quality assurance responsibilities after the open loop of parts market? Re-design quality assurance system and process
- How to copy with threat by internet companies?

Appendix 1: Introduction of PwC and Our Service to Automotive Industry

2

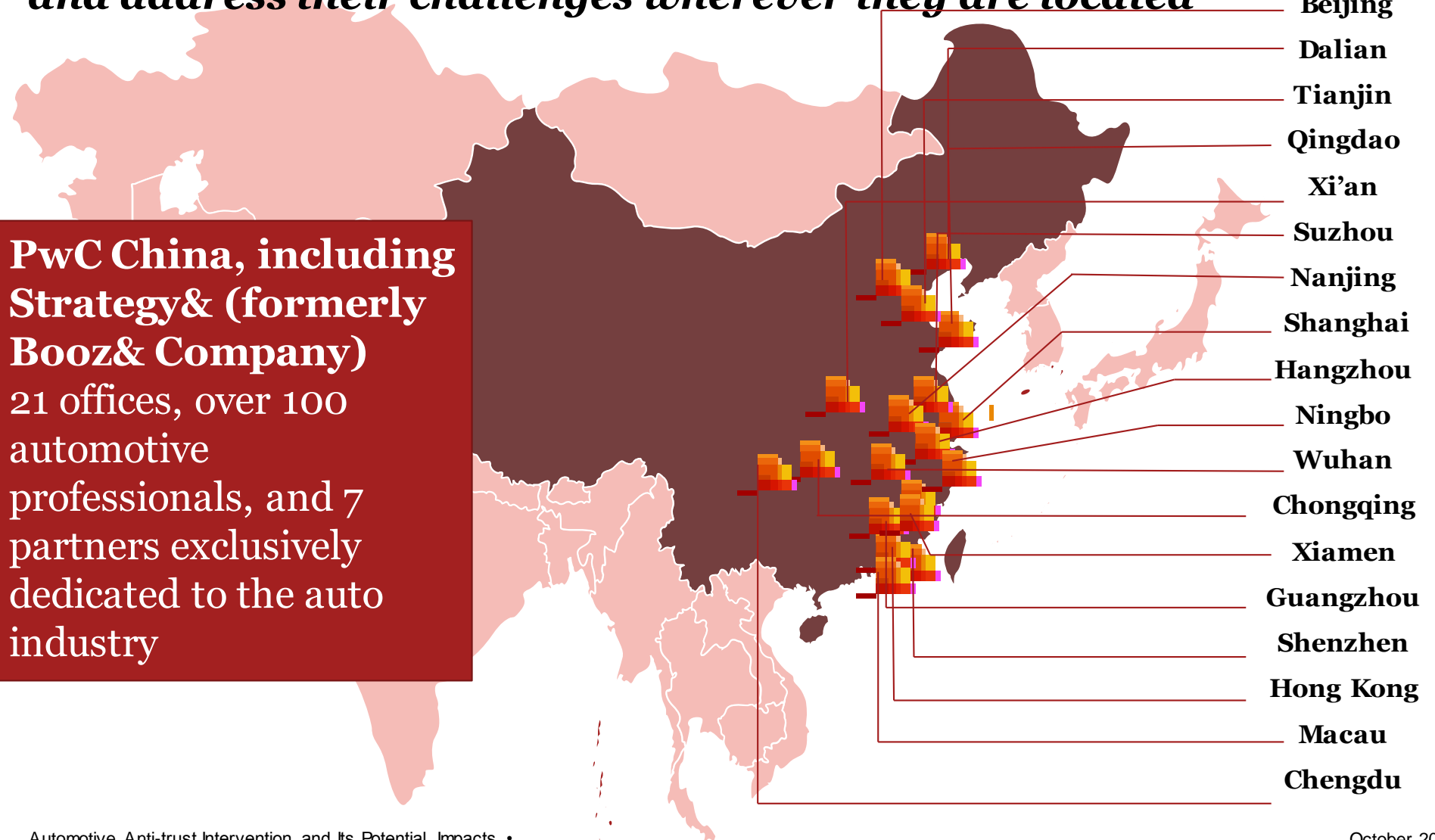
PwC Network of Firms

PwC’s global automotive practice leverages on its extensive experience across multiple industries, lines of service, and its global network of 4,800 automotive experts to assist clients in solving complex strategic and operation issues with both efficiency and quality



Our offices and automotive experts are distributed in all major cities throughout China, which enables us to support our clients and address their challenges wherever they are located

PwC China, including Strategy& (formerly Booz& Company) 21 offices, over 100 automotive professionals, and 7 partners exclusively dedicated to the auto industry



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Automotive Value Chain

Current Challenges (examples)

Service Capabilities (examples)

Strategy	<ul style="list-style-type: none"> • Explore new product segments in China • Establish production and sales operations overseas • Growth opportunities in tier 4 & 5 cities • International competitiveness of Chinese OEMs • Respond to production overcapacity 	<ul style="list-style-type: none"> • Growth strategy / Business model / value chain innovation • Inbound / outbound investment support • Dynamic tool-based demand forecasting • M&A and transaction support • Resilient organization / culture change
Research and Development	<ul style="list-style-type: none"> • Tailor vehicles to specific Chinese customers' needs • Regulation / incentives for MNCs to localise R&D • Push from Government to enter low-end segment 	<ul style="list-style-type: none"> • Voice of Customer (VoC) • R&D benchmarking • IB investment strategies • Technology roadmap
Supply Chain & Production	<ul style="list-style-type: none"> • Growing supply chain complexity • Shorter product launch cycles 	<ul style="list-style-type: none"> • Supply chain integration and strategic sourcing • Manufacturing benchmarking and optimization • Effective cost management
Sales and Marketing	<ul style="list-style-type: none"> • Dealer profitability and overall performance • Differentiating brand and customer experience • Repeat purchases / customer loyalty 	<ul style="list-style-type: none"> • Brand strategy / Product positioning • Dealer performance reporting & improvement • Digital proposition / targeted marketing spending • Sales channel (CRM) integration and optimisation
Aftersales	<ul style="list-style-type: none"> • Increasing non-original parts competition • Increasing product and service complexity • Increasing customer focus on service 	<ul style="list-style-type: none"> • After market strategy • AS wholesale and retail process optimisation • AS e-business integration • Dealer AS service improvement / training
Financial Services	<ul style="list-style-type: none"> • Complex and evolving regulatory environment • Changing customer perceptions towards debt and financial instruments / low customer loyalty 	<ul style="list-style-type: none"> • Auto finance business innovation (insurance, operational lease, and car sharing strategy) • Dealer finance CRM performance improvement

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Automotive Value Chain

Subject Matter Experts and Primary Contacts

Strategy	<p>Jun Jin jun.jin@cn.pwc.com +86(21) 2323-3263</p> 	<p>John Jullens john.jullens@strategyand.pwc.com +86(138) 1637-6578</p> 
Research and Development	<p>Gordon Xie gordon.xie@cn.pwc.com +86(21) 2323-2112</p> 	<p>Gerd Moehrke gerd.moehrke@strategyand.pwc.com +49(172) 266-3303</p> 
Supply Chain & Production	<p>Gordon Xie gordon.xie@cn.pwc.com +86(21) 2323-2112</p> 	<p>Gerd Moehrke gerd.moehrke@strategyand.pwc.com +49(172) 266-3303</p> 
Sales and Marketing	<p>Steven Hai steven.hai@cn.pwc.com +86(21) 2323-2717</p> 	<p>Bill Peng bill.peng@strategyand.pwc.com +86(139) 1168-4563</p> 
Aftersales	<p>Simon Strom simon.d.strom@cn.pwc.com +86(10) 6533-2356</p> 	<p>Huchu Xu huchu.xu@strategyand.pwc.com +86(186) 0219-6711</p> 
Financial Services	<p>Gordon Xie gordon.xie@cn.pwc.com +86(21) 2323-2112</p> 	<p>Sarah Butler sarah.butler@strategyand.pwc.com +86(138) 1735-5416</p> 

What do you want to change?