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Auto Shanghai 2015: Despite Crackdown On Luxury, China's Market Still Lures Foreign Brands - But New Challenges Ahead

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A woman takes selfies with her mobile phone inside an Audi car during the 16th Shanghai International Automobile Industry Exhibition in Shanghai April 21, 2015. Reuters/Aly Song

SHANGHAI -- Record crowds surged into Shanghai's auto show this week -- all under the watchful eye of Benedict Cumberbatch. Images of the "Sherlock" actor, advertising MG, the old British car brand now owned by Shanghai's state-run auto group SAIC, line the walls of the subway tunnels leading to the China Exhibition Center, under the slogan "My Glamour."

And the British star hasn't been the only celebrity in evidence: French actress Sophie Marceau, Asian icons like singer Jay Chou and actress Gao Yuanyuan, and top industry figures like Renault-Nissan CEO Carlos Ghosn have all appeared in person at the new purpose-built venue -- one of the largest in the world, with two levels, each featuring eight massive halls.

It's a reminder that despite a slowdown in sales growth, halving to 6.9 percent last year from 13.9 percent in 2013, China's auto market remains the largest in the world, its pulling power undimmed for automakers and stars alike. Sales last year were more than 23 million, compared to around 16.5 million in the U.S. And analysts predict the expansion will continue.

“The market is still growing. Incremental growth should be around 1 million per year. This is sustainable,” said industry expert Yale Zhang, managing director of consultancy AutoForesight. “For the largest market in the world to still be growing at this kind of rate is amazing. The slowdown is definitely just relative.”

The Chinese market is certainly changing, though. Experts say road saturation and environmental concerns (<http://blogs.wsj.com/chinarealtime/2015/03/24/chinese-urbanites-reconsidering-car-ownership-study-finds/?mod=WSJBlog>) have led to a slowdown in previously exponential sales growth in big cities, though some predict a growth in car rental fleets and car pooling. But a recent study (<http://www.shanghaidaily.com/business/autotalk-special/Tracking-the-trends-as-urbanization-expands/shdaily.shtml>) by analysts at PricewaterhouseCoopers suggested there is still huge potential for growth in several hundred smaller towns and cities. Where there may be a downturn is at the very top end of the market.

One type of model was conspicuous by its absence at this year's Auto Shanghai – the female glamour models, often in revealing costumes, who for many years have been a staple of Chinese car shows. The decision by organizers to ban the women has been seen as a symbol of the more puritanical mood currently being promoted by China's leadership, which has launched a major campaign against corruption and excess. Experts say a knock-on effect of the anti-corruption campaign on top-end car sales, a booming sector in China in recent years, is inevitable.

“It is hitting the ultra-luxury sector in terms of conspicuous consumption,” said Bill Russo, a Chinese auto industry veteran and managing director of consultancy Gao Feng Advisory Co. “If we're talking about Lamborghini or Ferrari or Rolls Royce, there are certain individuals who don't want to have their children be seen as being too overboard in terms of what they're buying.” The Ferrari crash (<http://www.scmp.com/news/china/article/1028489/how-crash-cover-threatens-career-hus-top-aide>) in 2012 that killed the son of prominent official Ling Jihua, leading eventually to his arrest on corruption charges, didn't help.

But Russo said “more mainstream luxury brands” like Mercedes, BMW and Audi “have not been hurt by this movement. They're as strong as ever. It's demographics,” he added, noting more than 2 million premium vehicles were sold in China last year. “The sheer number of people who can buy products in that class is increasing. The size of the pie is getting bigger, and the luxury share is growing too.”

That's good news for premium vehicles priced less than US\$150,000, including the ‘big three’ German brands, which take up around 70 percent of the sector in China, and others such as Jaguar Land Rover, which has been expanding its market share in the country. All launched new models at the Shanghai show, while Ford launched the Taurus, and Lincoln its new MKX, among others.

But in such a dynamic market, even these big brands need to adapt. Jaguar Land Rover's star new model in Shanghai was its Chinese-made Range Rover Evoque, while Mercedes, Nissan and others also launched new SUVs. In a country where the luxury sedan sector has long been the core of the market, SUVs have seen an explosion in sales in the past couple of years, growing by more than 50 percent in 2014.

On China's busy urban roads, drivers simply “feel that a higher vehicle is safer,” Zhang said, adding the rapid expansion of China's highway network in the past half decade also means “the roads are now good enough for long-distance driving, and sitting in an SUV driver's seat is more comfortable.” Equally significant, Zhang said, owning an SUV is also a “social statement -- it's a bit more expensive than the average sedan, and more stylish. Many younger drivers think it shows that you have better taste.”

In an aspirational society like China, such factors can be important, and the advertising campaigns of the big brands are quick to reinforce the message: “The new young force -- let yourself go,” proclaimed an ad for Nissan's latest SUV from a giant poster looming above Auto Shanghai's central courtyard. BMW, meanwhile, emphasized that its new X5 SUV was a

hybrid, which could be charged at home -- a reminder of both the environmental concerns some young drivers say they now take seriously and of the lack of charging stations, which observers say is still holding back the growth of the sector in China.

The boom in the SUV sector also hints at a challenge to the established order in the Chinese market. Last year, eight of the 10 best-selling SUVs in the country were made by domestic (<http://www.reuters.com/article/2015/04/17/us-autoshow-shanghai-suv-idUSKBN0N806820150417?feedType=RSS&feedName=businessNews>) brands, a dramatic change from 2013 when there was only one Chinese model in the top 10. Russo said foreign brands have been able to dominate the passenger car market because they entered this sector in the 1990s when purchasing power in China was lower, and therefore priced their models competitively, but their strategy in the SUV market has left them more vulnerable.

“In every market, the pricing model for SUVs is typically higher than that for passenger cars,” he said. “So the attitude that the multinational companies took in China was 'OK, let's price these SUVs higher' -- they went for the upper end of the pyramid. But,” Russo added, “they left a space for others who were willing to make less profit per unit, allowing Chinese brands to gain a profitable and potentially sizeable beachhead in the midmarket, an entry point that they simply didn't enjoy in the passenger car space.”

Zhang went further: “Some foreign brands were led astray by their confidence after locking up the sedan market,” he said. “Some only have one or two SUVs, but consumers have different needs -- you need a wider range to do well in the market now.” And if the Chinese brands are competing partly on price, Zhang said there has also been a significant improvement in their technology and quality.

“If you look at the exterior styling and interior craftsmanship, if you cover up the logos nowadays, you can't tell if something is a foreign product or a local brand,” he said. The days when one Chinese SUV performed alarmingly poorly (http://en.wikipedia.org/wiki/Landwind_X6) in a 40 mph collision test in Germany, a decade ago, are now long gone, he added.

Pierre Leclercq is a symbol of this change. After a 13-year career designing vehicles including SUVs for BMW, he now works for China's Great Wall Motors, one of the country's longest-established private brands. At Auto Shanghai, two of Leclercq's prototypes for Great Wall's Haval brand have been in the spotlight, gleaming on their rotating plinths. The company's latest model, the Haval H8, meanwhile, is one of the most expensive Chinese-made SUVs, retailing for around \$30,000.

Leclercq said the company has a clear strategy of moving up the value chain by concentrating on the SUV sector: “About three years ago the boss decided to focus on one market,” he said. “They studied the Chinese market, and others too, and saw that SUVs were very successful. So instead of trying to do many things not correctly, they decided to only do SUVs and to go up in the premium market.”

He acknowledged he took a risk in career terms by moving to China, but felt the company was serious about its development, was hiring experienced international staff and was willing to give them the chance to “design cars that we like. And in the end this is what we like about our job!”

Great Wall's prime focus is the domestic market, Leclercq said. “There's still a lot of potential for a brand like this to grow, because there are still many Chinese people who don't have a car, and will soon be able to buy a car -- not an especially expensive one, maybe not a Mercedes, but they will be able to buy our brand, and be proud of a Chinese brand.”

Ultimately, though, Great Wall aims to compete internationally -- if not yet at the top end of the market then at least in the same segments as cars from South Korea, for example. With dozens of Chinese auto brands, Leclercq said, “You must become global if you want to survive.” Leclercq noted Haval sold 150,000 of its 750,000 vehicles abroad last year, and is

building a plant in Russia. It already has a plant in Bulgaria and is also expanding into South America.

Zhang said Chinese brands are not likely to make a major international impact immediately, but with more and more [companies \(http://blogs.wsj.com/chinarealtime/2015/04/22/from-mini-designer-a-chinese-car-on-steroids/\)](http://blogs.wsj.com/chinarealtime/2015/04/22/from-mini-designer-a-chinese-car-on-steroids/) hiring foreign designers, he said they could do so within a decade. One sign of this potential shift came with this week's announcement that Volvo, which was bought by Chinese company Geely Motors in 2010, was planning to [export \(http://edition.cnn.com/2015/04/20/asia/shanghai-auto-show-volvo/\)](http://edition.cnn.com/2015/04/20/asia/shanghai-auto-show-volvo/) Chinese-made cars to the U.S.

Some experts say perceptions of the quality of "made in China" products have changed enough for this to no longer be an issue. "There's no reason for Volvo not to make cars here and sell them outside China," Russo said. "If a vehicle carries a foreign brand and is made to the standards of [an] international partner, there's no reason to worry about a foreign product made in China."

One thing that has certainly been made clear at this year's Auto Shanghai is the continuing ambition of China's automakers. Some companies, which have traditionally played second fiddle to their foreign joint venture partners, are now developing new brands of their own -- such as Aeolus, a new brand [launched \(http://europe.autonews.com/article/20150311/ANE/150310994/psa-starts-output-in-china-for-dongfengs-domestic-brand\)](http://europe.autonews.com/article/20150311/ANE/150310994/psa-starts-output-in-china-for-dongfengs-domestic-brand) jointly by Peugeot-Citroen and its Chinese partner Dongfeng Motors.

And even in a crowded market, new Chinese players continue to appear. In Shanghai over the past week, Jiangsu province's Kawei Auto was proudly displaying its "Cross Country SUV," retailing for just \$20,000, under the slogan "American Style." Zhejiang province's Zotye (known in Chinese as Zhongtai), a company relatively little known even in China, showed an entire range of gleaming new products, from a Smart-sized minicar to compacts, sedans and, of course, SUVs.

Some smaller Chinese brands have been [criticized \(http://www.thedetroitbureau.com/2015/04/chinese-turn-car-clones-into-high-art/\)](http://www.thedetroitbureau.com/2015/04/chinese-turn-car-clones-into-high-art/) for being less concerned with IPR than with building their brand, but there's no doubting their ambitions. With some 27 domestic brands currently, the market is likely to consolidate in the coming years, according to industry expert Zhang -- but he said some firms, like Zotye, are serious about expanding. Not all will achieve the stated goal of Kawei Auto -- "To build the most respected auto industry group" -- but there's no doubt that while China continues to attract the world's biggest automakers, its own brands, which have been learning from them for three decades now, are beginning to spread their wings.

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