Viewpoint

The China light van segment

A dynamic market with increasing volume and shifting needs

The light van market in China seems to be a long-forgotten segment for foreign OEMs. The market is mostly in low-tier cities and rural areas where customers have limited budgets. As a result, most foreign OEMs have not paid too much attention to it, despite the size of the market (around 3 million units in 2014). Yet upcoming regulation and a shift in customer usage may modify the current market landscape and open a new door for foreign players.

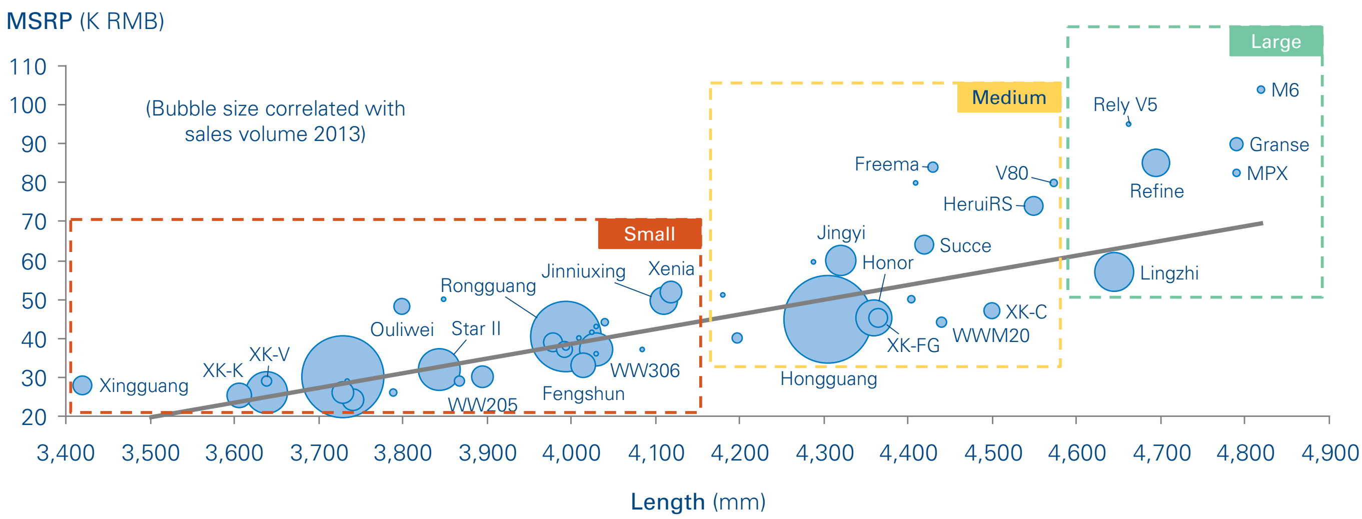
Market overview

Based on our market experience, the light van segment includes all models with van body types within 3.5 to 5.2 meters.

The light van segment is definitely a local market for its usages and brands:

- The light van segment is a low-cost market, with sticker prices ranging from RMB 30K to 80K.
- The market is dominated by local brands, with Wuling, Dongfeng and Chang'an accounting for 80% of market share. Foreign OEMs have an insignificant market share.
- More than 95% of vehicles are sold in their passenger versions (with back-row seats and windows), avoiding the costly and restrictive usage linked to cargo versions.

Segmentation of China light van market



Note: MSRP = Manufacturer's suggested retail price
Source: Arthur D. Little analysis, CAAM (China Association of Automobile Manufacturers)

Market trends and challenges

Diverse usages and purchase criteria

The major market demand comes from low-tier cities and rural areas. Major customer groups are small-business entrepreneurs and individuals. The light van is sometimes their only vehicle, and is hence used for both cargo and passenger transport.

Clients more on cargo usage tend to value basic car features such as price, reliability and space. Clients more on passenger usage are similar to customers of entry segment passenger vehicles and have a wider spectrum of criteria, in addition to price: styling, safety, comfort, space, etc.

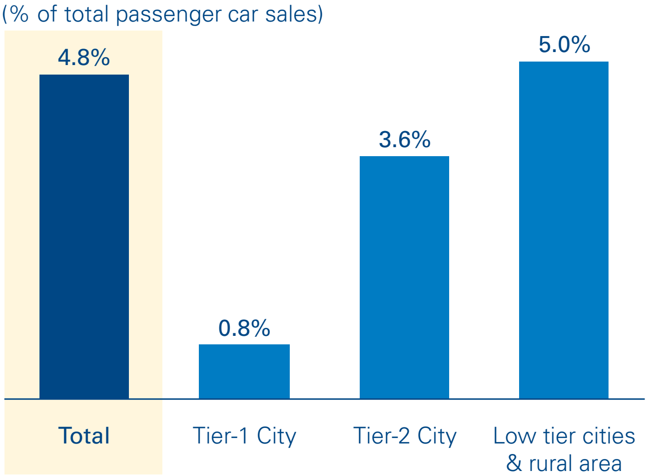
Market key success factors and best practices

China's light van segment presents unique market features linked to its stage of development and size as a country. OEMs need to master a few key success factors:

1. Design-to-cost: The price is still essential to entering the segment, with levels usually challenging for foreign OEMS to meet. Cost leadership is required, and should cover all aspects – product development, sourcing, manufacturing, marketing, sales, etc. Full localization of products is required, with a mature supplier base and supply chain. This is an area where cooperation with local OEMs could be beneficial. Local OEMs have been competing in the low-cost environment for a long time, and can provide this design-to-cost capability. In addition, they have very limited product development capabilities to meet future requirements, and would value partnerships with foreign OEMs.
2. Product portfolio to target diversified needs: With 3 million customers spread out across China, including the most remote regions, the market has diversified needs on usage, budget and priorities. All successful OEMs in the segment have portfolios of several models, each targeting a specific need, e.g. low-cost models for cargo transport and upgraded versions for passenger transport.
3. Extensive dealer coverage: Unlike the concentration of passenger-car customers in cities, millions of light van customers are scattered across the vast territory of the whole of China – villages, towns and small cities. In addition, with intensive usage and lower-quality standards, the current light van models normally require more frequent after-sales service. Hence, dealer network presence down to low-tier cities and rural areas is essential. Such a footprint is usually not the one of joint ventures and foreign OEMs.
4. Cost-effective marketing: Target customers tend to have, on average, less sophisticated information channels and decision-making processes, and are more likely to be influenced by marketing campaigns. Due to limited margins, many OEMs use down-to-earth marketing approaches (e.g. Wagon Tour) to provide direct interaction with customers.

Medium segment penetration by City Tier 2013

(% of total passenger car sales)

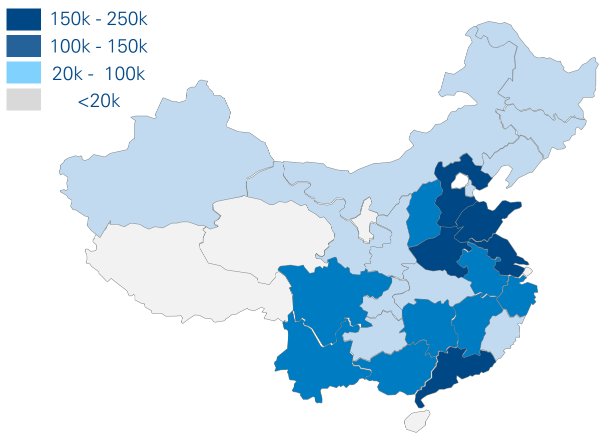


Note: Tier 1 = Beijing and Shanghai, Tier 2 = 28 large cities
Source: IHS Global Insight

These market characteristics and key success factors have led to a highly consolidated market – 80% of the market share is dominated by three OEMs (Wuling, Dongfeng and Chang'an).

Light van market by province (2013)

Map color stands for annual sales volume of local mini-van



Volume is becoming more balanced between coastal and inland provinces; inland has higher potential

Source: ADL analysis, expert interview

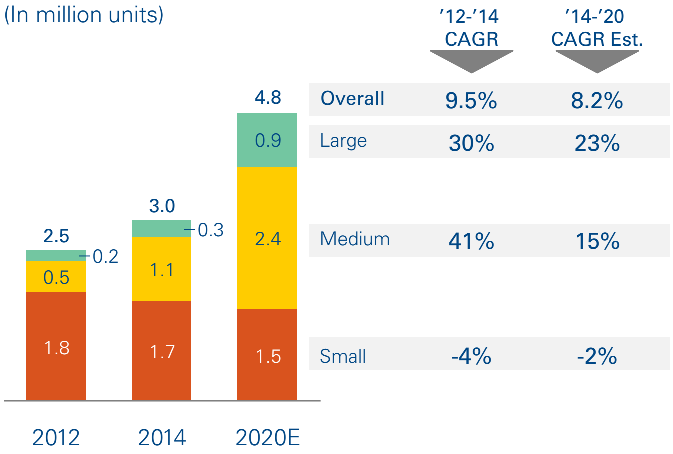
Future outlook and game changers

Growth forecast

Overall, looking ahead, the light van segment in China has significant growth potential. The growth rate is expected to be slightly lower than the overall passenger vehicle market.

China light van market trends

(In million units)



Source: Arthur D. Little

The fundamental growth driver is the increasing motorization and demand for transportation in low-tier cities, which should have faster growth than higher-tier cities. With increased customer income, light vans are probably the most accessible car that citizens can afford for multipurpose transportation usage. In addition, to some extent the easing of China's one-child policy will stimulate the segment volume in the medium term, because light vans offer wide space and seven-seat versions on many models.

The small segment (length of 3.4–4.2 meters) includes the cheapest car available in the Chinese market. This segment has already been decreasing for the last two years, and is likely to continue shrinking. The reason is that the average income of customers has increased in recent years, and customers are able to look at more comfortable and pricey models. Larger segments (e.g. 4.2–4.6 m) should benefit from the same upgrade trend.

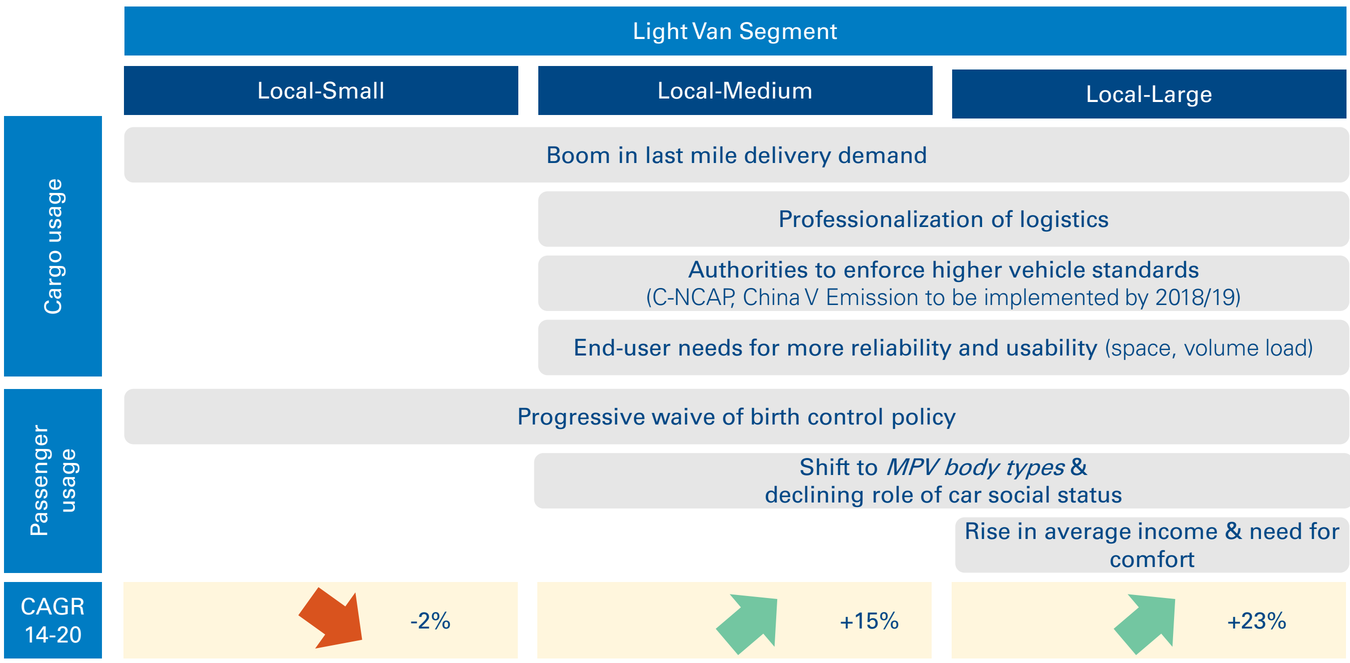
The end of the grey regulation?

Currently, government regulations on safety and emissions are loose, allowing this low-cost light van market to coexist with a passenger vehicle market with higher standards. C-NCAP (China New Car Assessment Program) does not include most light van models. Only four tested local light vans have two- and three-star performance in C-NCAP. If the stricter safety regulations are implemented, the OEMs will be forced to upgrade the models at higher costs. Also, if the status quo is to prevail in the misusage of van passenger versions for cargo transportation in the short term, regulations might change in the future to align with international safety and comfort standards. This shift would be more favorable to foreign OEMs' LCV ranges.

Professionalization of logistics

A potential future growth driver is the shift in the professionalization of logistics, in particular for the last mile. Most last-mile deliveries are still using motorbikes or tricycles and only limited light vans. Coupled with poor planning and a limited tracking system, this logistics chain produces a series of problems related to service, safety, pollution and cost. With e-commerce giants investing heavily in the logistics chain, major improvements are expected ahead, including an upgrade of the vehicles to enhance uptime and TCO.

Potential trends for light van segment (2015-2020) & impact on market growth



Potential demand for electric vehicles

Electric vehicles are another emerging and interesting segment. In July 2014, the central government announced an updated NEV stimulus plan, and 80 NEV pilot cities published their NEV targets for 2015, in which city logistics vehicles would add up to several thousand units. In some cities local governments encouraged logistics companies to purchase electric light vans by offering free license plates and road permits. LCVs are definitely an area in which the government would like local OEMs to develop NEV models.

Implications for foreign OEMs

The LCV market presents tremendous opportunities ahead for foreign OEMs. In order to tap this potential, the priorities are to:

1. Analyze customer purchase and usage behavior for each customer group
2. Assess impact of trends and regulation on the market (e.g. city restriction, the emission standard, body configuration, customer preference, etc.)
3. Conduct competitor benchmark for product and go-to-market approach
4. Develop market entry strategy with right product concept, clear target customer group and sales & marketing strategy
5. Screen and select the right Chinese partner for LCV business

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