Analyst Note>

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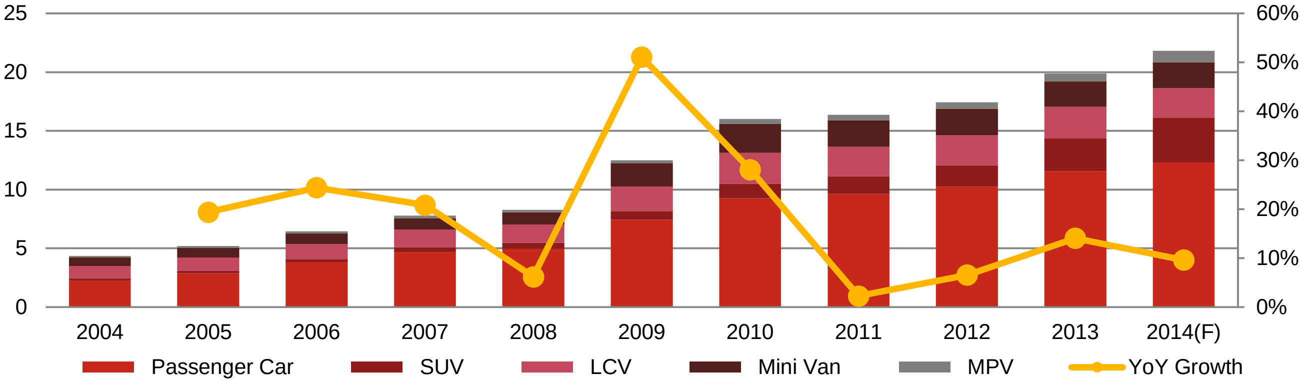
China: The emergence of auto finance

A glance at the growing auto finance market

When compared to mature markets, the majority of new car buyers in China still prefer to pay for their purchase with cash. Shifting consumer behaviors, particularly among a growing class of younger buyers, may serve as a catalyst to change this trend.

China: Light Vehicle Sales by Segment
2004 – 2014 (millions)



Source: Autofacts Analysis, CBU 2014 Sales Reports

Quite the decade for China

Within the last ten years, China has quickly emerged as the new epicentre of the automotive industry, with nearly a 17 percent compounded annual growth rate (CAGR) between 2003 and 2014. The sales environment and consumer behaviour has shifted with this burgeoning growth over the decade, including a growing appetite for larger, luxury nameplates as personal wealth per capita grows. One aspect that has remained relatively stable is the low take rate of using credit to underwrite new vehicle purchases. When compared to mature markets in North America and Europe, China still has a high rate of cash transactions, with many consumers taking pride in their ability to pay for big ticket items – like a new vehicle – with cash. Though auto finance has now been established for a decade, it still has not truly penetrated the market as a mainstream option. In 2013, only an estimated 20 percent of Chinese buyers opted for auto loans to finance their vehicle purchases. Mature markets like the US, France and Germany see much higher rates ranging between 50 and 85 percent of buyers using some form of financing to fund their purchase. Auto leasing options, though established in China, are even less popular as most consumers prefer outright ownership over what's perceived as temporary benefit with leasing. By comparison, the US has a leasing take rate of 14.5 percent for new vehicles while German buyers opt for leasing at an even higher rate of 35 percent. Overall, the perception of credit use and general understanding of various auto finance instruments among Chinese consumers is beginning to shift, giving the needed push to move auto finance out of the niche role it currently plays.

Next gen options for next gen buyers

As the millennial generation – those between the ages of 18 and 34 – is changing the sales and marketing environment in the US, so too is the next generation of buyers shifting the automotive landscape in China. This new generation of buyers have enjoyed a sustained period of economic prosperity in their formative years. Personal wealth of this generation has grown consistently, all while the social media and general connectivity are significantly augmenting the buyer experience. Given the younger generation's willingness to experiment with their purchases, auto finance lenders should cater their offerings as convenient, affordable and relatively low risk. Moreover, auto financing could be spun as a new and innovative method of purchasing a new vehicle, spurring higher adoption rates.

Another impactful change within new vehicle sales is the growing preference for bigger, premium vehicles. Consumer tastes have shifted towards higher-end luxury vehicles as well as large utility vehicles as material symbols of wealth. Such changes generally lead to higher average transaction costs, and financially savvy buyers will be more likely to consider a loan as a fiscally sound method of purchase.

Financing as a foot in the door

In traditional consumer purchases, credit and lending as a financing mechanism is generally seen as a one-time benefit for both the buyer and the lender, with a lower upfront cost for the buyer and a steady stream of income for the lender. Automotive captive financing and lending presents additional opportunities to become a service provider with involvement over the entire life cycle of a vehicle purchase. Aftermarket sales, maintenance, and warranties are all touch points that can start with the lending relationship and lead to additional sales and service opportunities.

Winners all around

Recognizing the benefits of a strong auto finance sector, the Chinese government has been promoting awareness around financial leasing of new vehicles. Officials are also considering relaxing the regulatory requirements to obtain auto financing licenses through the China Banking Regulatory Commission (CBRC). This softening environment should give rise not only to additional captive finance arms for OEMs, but also for more use of sophisticated auto finance instruments beyond the conventional loan – including leases. Now, with sufficient support from both the government as well as dealerships and OEMs and the added benefit of being classified as assets during lease terms, financial leases are expected to grow at a relatively healthy rate of 25% CAGR over the next five years[1].

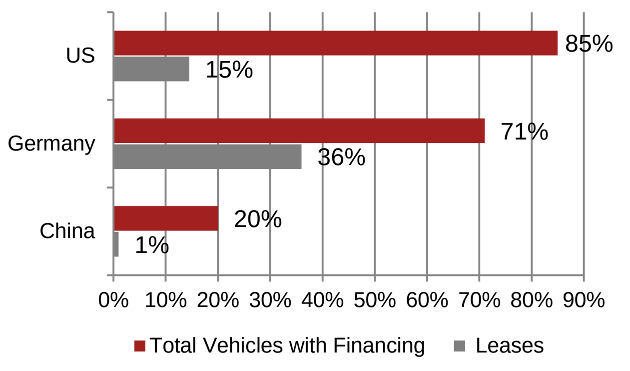
Should overall auto finance penetration rates increase as expected, captive finance arms from global OEMs are expected to lead the way. With existing experience in established markets, these lenders offer the quick and trusted auto finance practices. As the auto finance market matures, commercial banks may enter the fray as well. All told, stakeholders across the industry, from OEMs and their captive finance arms, to investors in auto asset-backed securities (ABS) markets, stand to benefit from an expansion of the auto lending business in China. As consumer attitudes soften on credit use and a new generation of buyers augment the auto retail model in China, opportunities to expand participation in auto finance will proliferate.

To find out more about how PwC can help in developing strategies for the changing auto finance landscape in China, visit pwc.com/auto.

1 21st Century Business Herald, 2013

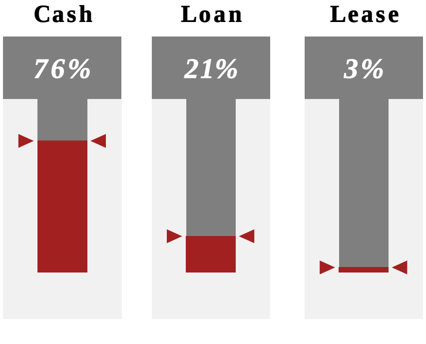
Share of New Vehicles with Financing

Select countries, 2013



Survey: Chinese consumer auto finance preferences

2014



Source: Autofacts Analysis, Experian Information Solutions, Bundesverband Deutscher Leasing-Unternehmen, PwC Report: "Shift from Ownership to Access – Car Leasing & Sharing (2014)