SYNDICATION/CHINA ENTREPRENEUR, PHOTO/GETTY IMAGES, CFP

BMW's Slowdown in China

As President and CEO of BMW Greater China, Karsten Engel, who assumed his office not long ago, inevitably encounters this question from doubters: Compared to the former CEO, Dr. Christoph Stark, can Engel push forward greater breakthroughs for BMW in China?

By Ma Jiying

Photos by CFP, Getty

Contemplating the question recently, Engel said with a smile, "I will not be conservative." On April 15, the ceremony for the completion of the world's first BMW brand experience center was held in Shanghai, and this was also Engel's first appearance in China. The 54-year-old German was radiant and smiling. Describing him as having big eyes and bushy eyebrows as is often done for some Chinese individuals was very appropriate in this case.

Before becoming President and CEO of BMW Greater China, Engel served as the Senior Vice President of BMW Germany. According to public reports, that was a key experience in his career. In 2010, BMW outshined Mercedes-Benz in Germany. Since then, BMW has established a dominant role in the German luxury car market.

Engel's confidence in part stems from such successes. "Experiences in the European market and the German market have made us become war-seasoned soldiers," he said. "We have to work very hard because overall market share is shrinking, yet each brand is striving to be first in the market."

It appears that Stark has laid a very favorable foundation for Engel: China has become the largest market for BMW in the world, and the second largest market for the BMW Group (composed of BMW, MINI and Rolls-Royce). The annual increase in sales for BMW in China is equivalent to the total annual sales volume of its fifth largest market in the world.

But the problem of sustainability and growth quality behind this rapid development is also pressuring Engle. In this year's first quarter, the sales volume of BMW Group in China increased by only 7.6%, while Audi, its most powerful rival in China, maintained a growth rate of 14.2%, nearly two times of that of BMW.

Luxury Sales Lagging

The overall situation of the auto industry is also changing. In the first quarter of 2013, China's luxury car market failed to maintain its previously high growth rate of 30%, due to the impact of economic slowing and some government measures. Worse, the luxury market's sales growth rate was only 4%, even lower than the average growth rate for the whole auto market.

Engel said that he was looking forward to working in China because he could enjoy the "feeling of a continuously growing market." However, his optimism might have been dampened after attending the BMW Annual Dealer Conference, held in early March in Thailand. Despite the excellent market situation in general, Engel heard numerous complaints of business losses being experienced by BMW dealers.

A general manager of one 4S shop (Sales, Service, Spare parts and Surveys) who has participated in the annual conference for several consecutive years said that the atmosphere of the annual conference in 2012 was not as cheerful compared to previous conferences. "We all are suffering from losses. In previous years, the annual conference was held to celebrate our successes, but in 2012, for the focus was on review and summary, it was with much less of a feeling of celebration."

The luxury market's sales growth rate was only 4%, even lower than the average growth rate for the whole auto market.

Dealers are still worried after the price war in 2012. In early 2012, various media reported the news of sharp price reductions for Mercedes-Benz, while speculation fell on BMW as the market follower. Soon afterward, news about price cuts at Audi, which has always maintained an image of price stability, was also heard. The unit prices of some luxury car models were reduced by tens of thousands of dollars, or were offered on the basis of "buy one, get one free."

The general manager mentioned above assessed the situation for this reporter. In the auto industry, the gross profit margin of sales available to dealers is about 8%-10% on average. For example, supposing the annual sales revenue of one 4S shop is $163 million the gross profit can reach $16.3 million if all cars are sold according to the recommended manufacturer's retail prices. After deducting various costs, the annual net profit is about $8.1 million, i.e. 5%. But if the sales price for a single car includes a 5% discount, the marginal sales profit will be zero.

The real situation is even crueler. In 2012, the BMW Series 7, the model generating the biggest profit for dealers, also experienced a sharp price cut, resulting in a domino effect undercutting the stable prices of all its models.

The results are predictable. The same general manager said that 2012 was a year of relatively poor performance for dealers. Although BMW once subsidized its dealers, comparing to the losses experienced by dealers last year, these subsidies were utterly inadequate.

What made them more depressed was the fact that although BMW Series 7 paid a heavy price in market share, sales volume did not rise sharply because of the price reduction. The chairman of one 4S dealer commented: "This is the saddest thing." His observation was that consumers prefer "buying when prices are rising." From a global perspective, the sales volume of two models including the BMW Series 7 declined in 2012.

However, these troubles were not reflected in BMW's global performance. Dr. Norbert Reithofer, Chairman of BMW Group, evaluated the market performance in 2012: "2012 is the most successful year in the history of BMW Group." In 2012, the sales volume of BMW in China exceeded 300,000 for the first time, an increase of 40%.

For Engel's predecessor, Stark, the above sales performance was a perfect end for his eight-year term of office in China. As Stark's successor, Engel is just starting to meet the current challenges. Engel likes to tell the story of his first contact with China and Asia 19 years ago. He then served as a regional manager in Singapore. The Chinese market was a relatively small one which he was also responsible for. In 1995, he built China's then-largest 4S shop in Shenzhen; today, however, that store is far behind the size of BMW's new stores in China.

To manage such an important and huge market, Engel needs to do much more than tell stories. Since officially taking office on March 1, he has visited more than 30 dealers. Over the past several years Engel has kept the work habit of visiting 100 dealers each year. He intends to carry this habit into his new position, to look for new opportunities for the development of BMW in China.

After-Sale Profits

Searching for new opportunities is not a matter of luck, but comes from his 28 years' experience working for BMW, matched with the changes going on today in the China market. From 2008 to 2009, Engel served as the Senior Vice President of the BMW Group, and was responsible for developing the strategies for after-sale and marketing channels. Now, one of his major tasks is to change the business structure of Chinese auto dealers and improve the proportion of after-sale service sales revenue and profits for dealers.

From his perspective, the current slowdown in the China market's growth is perhaps the best opportunity for making adjustments. Currently, there are already 1 million BMWs in the China market, including nearly 50% of the new cars sold over the past two years. Such a large volume will provide a reliable guarantee for after-sale profits for dealers over the next several years.

This happens to coincide with the needs of BMW dealers. An anonymous BMW dealer said that they are learning about the customer management experience from the telecom operators, and have put forward the concept of lifetime value of a customer to calculate the sales income contributed by one user to the 4S shop annually. By resuming businesses such as service which were previously detached from dealerships, 4S shops hope to achieve smaller profits but quicker sales turnover through providing after-sale services.

However, it is not accurate to define the main thrust of BMW in the China market as simply how to improve the profitability of existing channels. Like other auto brands, BMW has also found huge areas for development of the China auto market in markets beyond the first- and second-tier cities.

Currently, there are already 1 million BMWs in China, including nearly 50% of the new cars sold over the past two years.

A recent report produced by McKinsey indicates that consumers in nearly 100 third- and fourth-tier cities in China can afford to buy luxury cars. By 2020, the number of such cities will increase to 300. In 2012, the number of high-end cars sold in China reached 1.25 million, second only to that of the US. In 2015, China will surpass the US, becoming the world's largest luxury car market. By 2020, this figure is expected reach three million.

This is a big opportunity for BMW. Before Engel assumed his position, BMW's sales channels had expanded to third- and fourth-tier cities with an impressive record. In many county-level cities, BMW is the only luxury car brand with dealerships operating there.

This is a powerful means of improving market competitiveness, but also challenges the brand image of BMW. Could BMW advertisements, which usually appear in fashion magazines, or sponsoring top-level conferences, be one day seen on the electronic display screens of taxis in county-level cities? A brand manager for one BMW 4S shop exclaimed: "BMW's associates in China will definitely get mad!"

What are the possible solutions? Peng Bo, Director of Booz & Company in Greater China, put forward the concept of "the Tale of Two Cities." That is to say, luxury car manufacturers should value first-, second-, third- and fourth-tier cities alike, but network standards and marketing initiatives should be differentiated.

BMW is sensing the uncertainty in the China market and has thus prudently lowered its market expectations for 2013.

BMW wants to expand operations while preserving its luxury image.