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Prospective Automotive Financing in China

Concepts and Problems

Author: Thomas Elblinger
Supervisor: Stefan Brehm

Abstract

This Master thesis deals with prospective automotive financing in China. It is supposed to give a clear overview of the many confusing fragments existing on car finance in China in innumerable press articles and magazines. The paper thus answers who the competitors in the market are and what their aims are, how the actual market situation looks like, what the legal requirements are for automotive financing companies, which risks the market involves, and where strengths and weaknesses of competitors exist. Futhermore, possible consequences for car financers due to the competition, legal requirements, and risks in the market shall be scrutinised.

Therefore, the entire essay was divided into three major parts. The first described the two core groups of competitors, automobile financing companies and the big four Chinese state-owned banks and their aims. In the second part, market conditions were considered. Moreover, I explained the risks in that emerging market and stressed the importance of a sound risk management to minimise threats. The final SWOT analysis brought up strengths and weaknesses between competitors as well as opportunities and threats. Still, risks dominate the market but as I demonstrated foreign automotive financing companies do everything in their power to reach car financing heaven.

Keywords: *car financing, state-owned banks, credit risks, banking supervision, non-performing loans, China*

Contents

List of abbreviations

ABC	Agricultural Bank of China
AFC	Auto Financing Company
BoC	Bank of China
CBRC	China Banking Regulatory Commission
CCB	China Construction Bank
DER	Debt/Equity Ratio
EJV	Equity Joint Venture
GM	General Motors Corporation
GMAC	General Motors Acceptance Corporation
HSBC	Hong Kong and Shanghai Banking Corporation Group China
ICBC	Industrial- and Commercial Bank of China
NPL	Non-performing Loan
POS	Point of Sale
PRC	People’s Republic of China
ROE	Return On Equity
ROI	Return On Investment
SAIC	Shanghai Automotive Industry Corporation
SWOT	Strengths-Weaknesses and Opportunities-Threats Analysis
VW	Volkswagen Corporation
VWFS	Volkswagen Financial Services Corporation
WTO	World Trade Organisation

List of figures

1. Introduction

This paper is concerned with prospective automotive financing in China. In that respect, several concepts and problems will be outlined.

So far, there exists hardly specific literature regarding this matter. But since global car manufacturers such as Volkswagen (VW) and General Motors (GM) have entered China a whole new market situation is emerging. Thus, car industry became a cutting-edge topic and is since then discussed heavily in innumerable press articles and magazines.

The problem for the average person without any previous knowledge about this issue is that he only can read fragments and/or superficial news without any deeper background information. One task of this work is to put these pieces together to some extent and to give insights to interested parties.

The limits of a Master thesis, however, do not allow to discuss automotive financing in China in all its details. That is my focus is restricted on important parts of the greater whole.

So during the preparation for my fieldwork research in China I decided to investigate thoroughly two major foreign automotive car financing companies, namely Volkswagen Financial Services Corporation (VWFS) and General Motors Acceptance Company (GMAC).

In doing so, my aim is to find out whether foreign car financers' aims are satisfiable or not. This is an interesting question considered the temporary competition, the legal requirements, and also the threats and risks that participate in the Chinese car financing market.

To give a comprehensive overview of these matters the second chapter will introduce the competitors in the market, its structures, and also their aims. The next section deals with the market conditions. Here, legal requirements for foreign automotive financing companies find a place. Additionally, the risks for these institutions are explained. The fourth paragraph then gives a detailed overview of competitors' strengths and weaknesses. The outcome of this investigation is the basis for a critical strengths/weaknesses-opportunities/threats (SWOT) analysis which is conducted afterwards. The last chapter summarises my findings and also gives a forecast for the Chinese car financing market.

To go beyond the scope of press literature I designed a questionnaire which I then discussed personally during interviews with experts in automotive financing, Mister Daniel Levis, Credit Manager from GMAC-SAIC in Shanghai, Mister Ralf Wirtz, Sales Department Consultant and Mister Ulrich M. Gross, Marketing Consultant, both from VWFS in Beijing.

I want to thank Mister Levis, Mister Wirtz, and Mister Gross very much for their support and their efforts. Their statements and answers were utterly helpful and gave me the opportunity to look behind the scenes of the automotive financing business in China. I also would like to thank Doctor Stefan Brehm for his supervision and assistance during my fieldwork research and the writing of this thesis. Last not least, special thanks goes also to Ulf and Thorsten for their technical support.

2. The actors in the Chinese market for automobile financing

To start off, it is important to introduce the different actors in the Chinese market for automobile financing. There we can find three major groups which are competing over market shares. First of all, it is automobile financing companies. The second group are the domestic state-owned banks. The final section of this chapter deals with other possible competitors.

2.1. Automobile financing companies in China

After China's accession of the World Trade Organisation (WTO) in 2001 and the publishing of the necessary legal requirements of car financing for international auto financing companies (AFCs) in October 2003 the basis was complete for a business licence application. It seemed as if the market was open for everybody.

But this was not the case. Indeed, in order to apply for a licence for financing cars the respective company needs an invitation for their request to apply which is given out by Chinese government agencies. At first, this invitation was received by only a few institutions such as GMAC, VWFS, Toyota's finance company, and three Chinese companies (including Yafei Automobile Company and Nanjing Southern Auto).

Crucial to the invitation for the application of a business licence is basically the company's size, its goodwill and good name to avoid supervisory difficulties in advance. A further purpose of these invitations was to exclude companies without any automotive background. The Chinese government supports and protects the automotive sector and demands car financing institutions to foster the car industry by increased car sales. That is why enterprises without that specific interest in cars are not welcomed[1].

This thesis will focus on two AFCs which are VWFS and GMAC. These companies fulfilled the necessary requirements and also were invited to send in their application for obtaining the business licence for the Chinese market[2].

[1] Wirtz, Ralf (Sales Department Consultant, VWFS). Notes taken during the interview, Beijing, 2006-09-26
[2] Levis, Daniel (Credit Manager, GMAC-SAIC). Notes taken during the interview, Shanghai, 2006-09-22; Wirtz, R. (Sales Department Consultant, VWFS). Notes taken during the interview, Beijing, 2006-09-26

2.1.1. Company structures

Volkswagen Financial Services Corporation

The Volkswagen Financial Services Corporation opened their representative office in Beijing in 1998. This was relatively early. Actually two months before even the “Big Four” Chinese banks were allowed to operate in the car financing area in China. Since then the employees’ tasks were to push things forward until the company got its permission for doing its business in the country and also to prepare the market entry locally. This preparation included market research, lobby work, building up contacts with official institutions, and the handling of application formalities[3].

One month after the administrative and implementing rules governing the auto financing companies were published by the China Banking Regulatory Commission (CBRC), VWFS handed in all demanded documents in order to apply for the business licence as an AFC without any joint venture partner. It took until summer 2004 before VWFS was allowed to operate in the car financing market. Then they started in Beijing and one year later they had enlarged their range up to 25 Chinese cities[4].

The origin of VWFS corporation was a simple saving concept for buyers of the Volkswagen Beetle in the 1950s. It is a subsidiary company of Volkswagen Corporation (VW) and offers nowadays all kinds of financing and leasing concepts, insurance solutions, direct and online banking, as well as saving and investment possibilities to their customers. The services for automobiles are primarily customised for cars which belong to the VW group such as VW, Audi, Seat, and Skoda. Hereby, both business and end customers are considered. By now, this AFC finances around every third car of the groups’ sales worldwide[5].

General Motors Acceptance Corporation

GMAC’s office in China was established in 1998[6]. In the formal way it is not a representative office of GMAC but rather the financial services department of the General Motors Corporation (GM). The reason is that GMAC is not a registered legal entity in China[7]. Nevertheless, I will continue to talk about GMAC since this company is the office’s background, which is placed in Shanghai.

[3] Wirtz, R. (Sales Department Consultant, VWFS). Notes taken during the interview, Beijing, 2006-09-26
[4] Wirtz, R. (Sales Department Consultant, VWFS). Notes taken during the interview, Beijing, 2006-09-26
[5] VWFS http://www.vwfsag.de/vwfs/0,,0-0-100001185-1,00.html, last visited on 2006-11-05
[6] GMAC-SAIC: “Presentation for Third Parties”, 2006-04-06, slide 7
[7] Levis, D. (Credit Manager, GMAC-SAIC). Notes taken during the interview, Shanghai, 2006-09-22

In 2003, GMAC handed in their application for a equity joint venture (EJV) together with the Shanghai Automotive Industry Corporation (SAIC) in order to get the permission for car financing. So in the beginning the basic tasks for the Shanghai office were similar to the ones of VWFS. Both enterprises had to arrange the accurate entry to the car financing market. Nowadays, the GMAC-SAIC joint venture has a company share of 60 to 40 percent[8].

GMAC itself was established in 1919 as a subsidiary of GM. The original idea was to finance and to sell the excess cars which were produced only to take advantage of the production capacities[9].

Today, GMAC is one of the leading AFCs worldwide. Even if car financing is still their core business they shifted their focus from not only financing surplus cars to the whole range of GM products. Additionally, GMAC has enlarged its business sector by property financing and insurance services[10].

The main focus for GMAC is the support of GM dealers and to offer them the opportunity to finance their car stock[11]. Second, the financial service department directs its attention to private customers[12].

2.1.2. Aims

In my interviews I could figure out two major aims of AFCs. First, they must support the sales of their own brand's cars so they can strengthen and expand their dealers' market position. Second, VWFS and GMAC see a very lucrative business in car finance for themselves. Especially the latter was made clear by Daniel Levis, when asked for GMAC's incentives in the Chinese market: "To make a lot of money!"[13].

Car financing as a supportive measurement for VW and GM in China

The success in the car finance sector in China is very important for the whole VW and the GM group. Due to the hard struggle for bigger market shares in the car market the car manufacturers want to increase their sales rates by the support of their respective AFCs[14].

[8] GMAC-SAIC: "Presentation for Third Parties", 2006-04-06, slide 3
[9] GMAC http://www.gmacfs.com/us/en/about/history/index.html, last visited on 2006-11-05
[10] GMAC http://www.gmacfs.com/us/en/about/business/index.html, last visited on 2006-11-05
[11] Levis, D. (Credit Manager, GMAC-SAIC). Notes taken during the interview, Shanghai, 2006-09-22
[12] GMAC http://www.gmacfs.com/us/en/about/structure/index.html, last visited on 2006-11-05
[13] Levis, D. (Credit Manager, GMAC-SAIC). Notes taken during the interview, Shanghai, 2006-09-22
[14] Gross, Ulrich M., (Marketing Consultant, VWFS). Notes taken during the interview, Beijing, 2006-09-26

According to VW, the car maker could increase its auto sales by 29.5 percent in 2006[15]. Certainly, car loans played an important role sales to achieve that figure.

VWFS and GMAC try to achieve this aim by generating new buyers for their parent company due to their financing offers. This new kind of buyers consist of private and business customers who do not have the sufficient liquidity to pay the whole price of a car in cash. But they are creditworthy enough so that they come into consideration for financed cars[16].

Another increase in sales is to be achieved by supportive measurements for the dealers. Since automotives are sold only by them they play an important role. In what way VWFS and GMAC offer special assistance to their salesmen will be discussed in chapter 3.2.1..

VWFS and GMAC finance and support mostly their own brand. One could assume that AFCs thus do not compete amongst each other. However, the car producers and dealers themselves have a very active competition over market shares which surely affects the relationships between automotive financers.

Automotive financing in China as a profitable business for AFCs

In order to assess the market volume we need to have a closer look at the "retail penetration". This index gives the percentage of financed vehicles among newly registered automotives a year. For the Chinese market this indicator temporary pends above 10-15 percent[17]. GMAC could finance 10,000 vehicles in 2005 and increased this figure up to 15,000 concluded financing contracts by June 2006[18]. Provided steady sales, this is a projected increase in "retail penetration" of about 200 percent.

There is a steady increase in car sales even if it is not developing as heavily as it did in the past years. This can be proved by a slight oversupply of cars since the car makers expected a higher demand[19]. However, the market has good prospects anyway since the Chinese people's purchasing power[20] is growing sharply as demonstrated in the figure below. One can assume that due to this development Chinese are able to afford more auto credits in the future.

[15] Unknown (2006), "Absatzsteigerung: VW kriegt die Kurve in China", *Die Welt*, 2006-09-06
[16] Levis, D. (Credit Manager, GMAC-SAIC). Notes taken during the interview, Shanghai, 2006-09-22
[17] Levis, D. (Credit Manager, GMAC-SAIC). Notes taken during the interview, Shanghai, 2006-09-22
[18] Levis, D. (Credit Manager, GMAC-SAIC). Notes taken during the interview, Shanghai, 2006-09-22
[19] Levis, D. (Credit Manager, GMAC-SAIC). Notes taken during the interview, Shanghai, 2006-09-22
[20] Purchasing power is the amount of income which is left over after deducting all living costs such as for food, housing, and clothing. Therefore, it can be spend on other commodities, e.g. luxury goods.

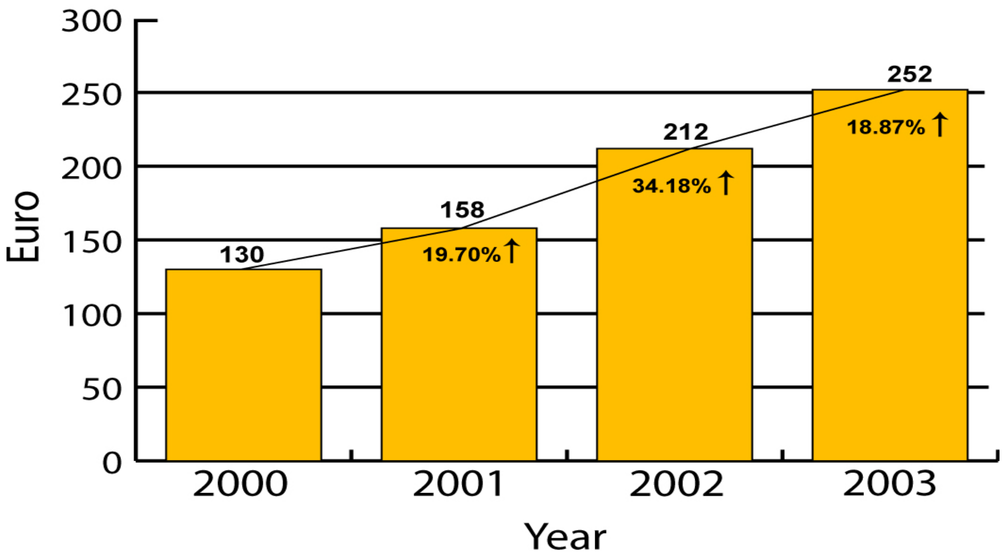

Figure 1: Development of annual purchase power per capita of urban Chinese households[21]

On the other hand, one has to be careful with too optimistic forecasts. The high Chinese population's saving rate of about 40 percent of their income, the highest saving rate in the world, and their preference to pay an automotive in cash might distort this positive picture[22]. VWFS and GMAC are aware of this point. They handle it through educational work towards the Chinese customer. That is they try to explain the possible buyer that it might be more appropriate not to spend all the savings on a car but to save it for bad times. It makes more sense to spend only parts of the money, where the customer is even able to drive a new model like the Sagitar (Golf V platform) instead of paying a big sum in cash for a former model such as a Jetta[23]. GMAC illustrates it simplifiedly that many of its products are available to the public for only two cups of coffee a day[24].

To improve the results for the Chinese car financing market it is vital to cut the operating expenditures. An indicator for this expenses in this business field is the so called "burden":

$$\frac{C}{E} = B,$$

whereby C = financed cars, E = employees, B = burden.

Figure 2: Illustration of the "burden"[25]

[21] Own calculations and illustration based on datasets from China.org.cn http://www.china.org.cn/english/en-sz2005/sh/biao/p104.htm, last visited on 2006-11-08
[22] Hofman, Bert and Kuijs, Louis (2006), "Profits drive China's Boom", *Far Eastern Economic Review*, Vol. 169, No. 8, p. 40
[23] Wirtz, R. (Sales Department Consultant, VWFS). Notes taken during the interview, Beijing, 2006-09-26
[24] Levis, D. (Credit Manager, GMAC-SAIC). Notes taken during the interview, Shanghai, 2006-09-22
[25] Own illustration

It gives the amount of financing contracts concluded by an AFC's employee per year. If the "burden" is high then the expenditures per credit contract are low. Consequently, is the "burden" low the costs per deal are high. That means AFCs' aim is not only a good sales volume but also an improved return on investment (ROI).

2.2. The domestic competitors: the "Big Four" Chinese banks

The "Big Four" Chinese state-owned commercial banks are seen as the strongest competitors for automotive financing companies.

2.2.1. Structures

This paragraph aims to give a brief overview of the four major banks in China. Since these institutions are very similar compared to each other it seems to me more sensible to talk about the Chinese banking system with its tasks and problems as a whole than to describe particular characteristics of each bank.

The "Big Four" consist of the four biggest state-owned Chinese banks[26]. These are in alphabetical order:

- Agricultural Bank of China (ABC)
- Bank of China (BoC)
- China Construction Bank (CCB)
- Industrial- and Commercial Bank of China (ICBC)

Originally, these banks were founded by the government to fulfill diverse specific tasks in different business sectors. But nowadays they are transforming into general commercial banks. That means they go beyond their former boundaries and take care of new territories such as car finance[27].

Especially after banking reforms in 2003, the "Big Four" are developing and try to act from economic principles. Apart from the ABC, all other state-owned banks are today listed on the stock exchange and have foreign investors which may hold a stake of up to 25 percent

[26] ABC http://www.abchina.com/en/hq/index.jsp/index.html, last visited on 2006-11-10;
BoC http://www.bank-of-china.com/en/static/index.html, last visited on 2006-11-10;
CCB http://www.ccb.com/portal/en/home/index.html, last visited on 2006-11-10;
ICBC http://www.icbc.com.cn/e_index.jsp, last visited on 2006-11-10
[27] Popp, Stephan (1996), "Multinationale Banken im Zukunftsmarkt VR China: Erfolgsfaktoren und Wettbewerbsstrategien", Wiesbaden, p. 43

as minority shareholders[28]. Another major change has been the creation of a supervising and regulating authority on the micro level, the CBRC[29]. On the macro level, they are supervised and controlled by the People's Bank of China (PBoC)[30], China's central bank, which takes care of economic stability of the banking system. That is also a very common practice for industrialised countries.

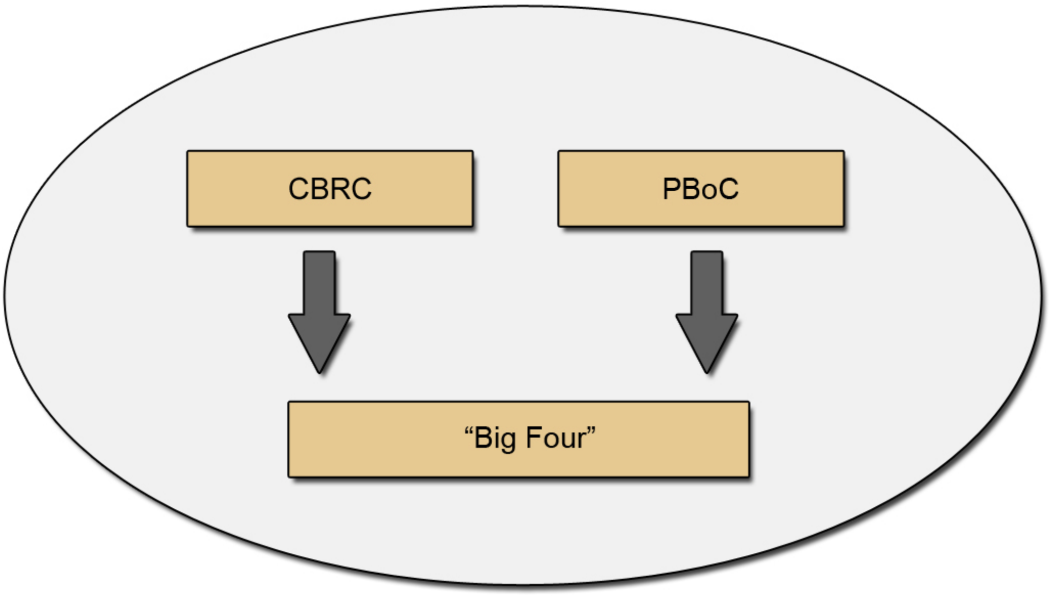

Figure 3: The domination of the "Big Four"[31]

Since the "Big Four" belong to the central government[32] China's officials can consistently interfere in their businesses. Thus it is not the state-owned banks which are responsible for granting of credits. No, it is the state. That is banks are forced to carry on their businesses after developmental, economical, and social policies set up by the government. Therefore, the "Big Four" are often used as money lender for ailing public enterprises and also for persecution of political aims. So it is hardly surprising 80 percent of all credits given out by state-owned banks go to public enterprises[33].

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[28] China Business Review http://www.chinabusinessreview.com/public/0605/thomas.html, last visited on 2007-01-04
[29] Unknown (2005), "China's banking industry: A great big gambling game", *The Economist*, Vol. 377, No. 8450, p. 78
[30] Popp, S. (ibid.), p. 43
[31] Own illustration
[32] Huang, Dawei (2002), "Der chinesische Bankensektor im Zeichen des WTO-Beitritts – Reformrückstände und Herausforderungen", *Berichte des Arbeitsbereiches Chinaforschung*, No. 17, Institut für Weltwirtschaft und Internationales Management der Universität Bremen und Internationaler Studiengang Volkswirtschaft, Hochschule Bremen, p. 31
[33] Huang, D. (ibid.), pp. 26, 27

The “Big Four” are sometimes seen more as government agencies than economic companies[34]. This constellation proves advantageous. State-owned banks enjoy governmental protection such as to wall them off from competition as well as they obtain financial support from the government because the state has such a strong interest in their well being. So these financial institutions are not really able to collapse. Therefore, their motivation for running businesses efficiently is lower than for AFCs[35]. This behaviour results in a worse performance for Chinese commercial banks[36]. Even after the reforms, inofficially estimates put uncollectable loans still at 20 to 25 percent of their credit portfolio in 2005[37].

There are five categories into which Chinese banks assess and divide their credits[38]. The criterion here is the number of days the repayment is overdue:

1. ***“Pass”***: Monthly instalments are paid regularly.
2. ***“Special Mention”***: Payments are overdue between 0 – 90 days.
   The institute is concerned about getting their money back.
3. ***“Substandard”***: Instalments have not been received for the last 90 – 180 days.
4. ***“Doubtful”***: After 180 – 360 days without seeing any money the
   banks regard the credits as doubtful.
5. ***“Loss”***: Has the credit been overdue for more than 360 days it is filed as a loss.

Classifications three to five are so called “bad loans”[39]. Of course, these kind of credits are unavoidable. That is why financial institutions always try to calculate the risk. The interest rate, which is the actual price for the borrowed money, includes this risk banks need to bear. Nevertheless, the share of the major Chinese commercial banks’ “bad loans” is with around eight percent (official number) in the first half of 2006[40] much higher than for banks in other countries where the uncollectable credits mostly do not exceed one percent of the entire credit portfolio[41].

Due to many “bad loans” the equity capital is very low for Chinese state-owned banks. The equity ratio describes the relationship between equity capital and risk-weighted assets,

[34] Huang, D. (ibid.), p. 32
[35] Huang, D. (ibid.), p. 34
[36] Huang, D. (ibid.), p. 41
[37] Unknown (2005), “China’s banking industry: A great big gambling game”, *The Economist*, Vol. 377, No. 8450, p. 78
[38] PBoC http://www.pbc.gov.cn/english//detail.asp?col=6400&ID=23, last visited on 2006-11-12; Levis, D. (Credit Manager, GMAC-SAIC). Notes taken during the interview, Shanghai, 2006-09-22
[39] PBoC http://www.pbc.gov.cn/english//detail.asp?col=6400&ID=23, last visited on 2006-11-12
[40] CBRC http://www.cbrc.gov.cn/mod_en00/jsp/en004002.jsp?infoID=2738&type=1, last visited on 2006-11-12
[41] Unknown (2005), “China’s banking industry: A great big gambling game”, *The Economist*, Vol. 377, No. 8450, p. 78

e.g. outstanding debts. It serves as a collateral of a bank's default risks. With the prescribed international standard (Basle Capital Accord of 1988) of 8 percent[42] in mind Chinese banks are struggling hard to achieve this aim. That is the "Big Four" hardly have equity capital as securities in case of outstanding debts turn into irrecoverable ones. At least, BoC and CCB fulfil this requirement due to an financial boost by the Chinese government of $45 billion in 2005[43]. It goes without saying that this action was done to let the banks' balance accounts look better.

Another negative aspect of these uncollectable credits are the unsatisfactory profits. Even if the number of credits is growing the gains are decreasing. Sometimes the state-owned banks' profits are not even sufficient to cover their losses[44].

Additionally, the labour productivity in these institutions is still low, too. In many cases the "Big Four" have surplus employees who are often unqualified or low-skilled[45]. That raises the costs enormously and reduces the profits even more[46].

2.2.2. Aims

Financing cars reduces the shares of uncollectable credits within the portfolio

Due to China's WTO accession and the resulting opening to the market the "Big Four" face a growing competition. Thus they are compelled by the government to reduce the share of these "bad loans". So car credits might be a part of the solution. So far, state-owned banks claim their failure quota to be less than two percent when it comes to car loans[47]. This quota is below the average credit default rates[48]. Therefore, the bigger the share of those consumer credits the smaller the share of irrecoverable loans in the over-all portfolio.

But one should rethink that logic. It's true that the relative value of uncollectable credits decreases if the portfolio is enlarged by car loans. However, through this measurement banks will not cut down the absolute value of "bad loans".

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[42] Bundesbank http://www.bundesbank.de/bankenaufsicht/bankenaufsicht_basel_saeule1.php, last visited on 2006-11-12; unknown (2005), "China's banking industry: A great big gambling game", *The Economist*, Vol. 377, No. 8450, p. 78

[43] Podbiera, Richard (2006), "Progress in China's Banking Sector Reform: Has Bank Behaviour Changed?", *IMF Working Paper*, Vol. 06/71, p. 5

[44] Huang, D. (ibid.), pp. 39, 40

[45] Unknown (2005), "China's banking industry: A great big gambling game", *The Economist*, Vol. 377, No. 8450, p. 79

[46] Huang, D. (ibid.), pp. 34, 35; Levis, D. (Credit Manager, GMAC-SAIC). Notes taken during the interview, Shanghai, 2006-09-22

[47] People's Daily Online http://english.people.com.cn/200407/12/eng20040712_149228.html, last visited on 2006-11-12

[48] The Glittering Eye http://theglitteringeye.com/?p=954, last visited on 2006-11-12

Furthermore, one must not forget that the state-owned banks' share of automotive credits amounts only to minority compared to other branches, e.g. real estate financing[49]. Thus its meaning for the reduction of non-performing loans (NPL) in the total portfolio is hardly worth mentioning. Additionally, many insurers that offer coverage of the residual debts and also other estimates complain about car loan default rates between 30 to 50 percent[50].

Automotive financing as a profitable business for the "Big Four"

As mentioned above the profits for the state-owned Chinese banks were decreasing and are still low due to the amount of "bad loans" even if their assets and lending are increasing[51]. The state wants this situation to be improved. Car finance is supposed to be a highly profitable business for these banks. Unfortunately, there exists no data on their actual performance. It seems, the "Big Four" have private reasons not to reveal those data sets.

Sometimes car financing is entitled as the future "cash cow" for lending institutes[52]. This term is associated with businesses which have a high market share and a low market growth. They are established and not much financial requirements are needed due to low competition in this field. Additionally, they generate a steady flow of profits which one just has to milk - a very "cash cow"[53]. Last year, the "Big Four" state-owned banks' outstanding auto loans added up to respectable 187.5 billion yuan[54]. The car financing sector is therefore an upcoming business with lucrative prospects.

Car loans to increase car sales and to boost the economy

Banks are furthermore compelled to extend the automotive financing business generate more car loans. This is supposed to increase private consumption and thus to boost the Chinese economy[55]. Some analysts expect the Chinese car market to grow that fast that it might overtake the US, which is still number one, by 2015[56].

It is difficult to measure the impact of car loans on the entire Chinese economy. It should be enough to mention that temporary only 10 to 15 percent of all car purchases come

[49] China.org.cn http://www.china.org.cn/english/BAT/186093.htm, last visited on 2006-11-12
[50] Survived SARS http://survivedsars.typepad.com/survivedsars/2006/10/auto_loan_numbe.html, last visited on 2006-11-12; Levis, D. (Credit Manager, GMAC-SAIC). Notes taken during the interview, Shanghai, 2006-09-22
[51] Huang, D. (ibid.), p. 39
[52] China.org.cn http://www.china.org.cn/english/BAT/53780.htm, last visited on 2006-11-12
[53] Unister http://classic.unister.de/Unister/wissen/sf_lexikon/ausgabe_stichwort439_0.html, last visited on 2006-11-12
[54] Survived SARS http://survivedsars.typepad.com/survivedsars/2006/10/auto_loan_numbe.html, last visited on 2006-11-12
[55] China.org.cn http://www.china.org.cn/english/BAT/185895.htm, last visited on 2006-11-13
[56] Federal Deposit Insurance Corporation http://www.fdic.gov/bank/analytical/banking/2005nov/article1.html, last visited on 2006-11-13

with a financing contract[57]. That is why I am not convinced if such a low ratio is able to provide a significant boost to the Chinese economy.

2.3. Other competitors

Besides established AFCs and the “Big Four” Chinese banks exist other competitors on the market which also court potential customers. Some already are succesful in doing so and got a piece of the pie.

Regional banks

Regional banks are basically focussed on close cooperation with several regional car dealers. Their relations are mainly based on “Guanxi”. This is a personal relationship network which is used for diverse businesses. Consequently, their reach of financing cars is actually limited to the reach of their networks[58]. So regional banks can be serious competitors in individual cases but their influence does not spread nationwide[59].

Foreign banks

At the moment, foreign banks are not represented in the automotive financing market in China. But this is about to change at the end of 2006. Then, for the first time, it will be possible for foreign banks to apply for licences for credit and deposit businesses in the local currency[60]. Then these institutions will be able to compete in this field, too.

For my conception, possible competitors then may be the Hong Kong and Shanghai Banking Corporation Group China (HSBC), Standard Chartered, and Citibank since these three have been present in China before the Public Republic of China (PRC) was established in 1949 and are thus familiar with the structures and characteristics of this Asian country[61].

However, starting from 2007, it will take several years for these new institutes to build up their own system and operate countrywide until they can challenge AFCs such as VWFS and GMAC[62].

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[57] Levis, D. (Credit Manager, GMAC-SAIC). Notes taken during the interview, Shanghai, 2006-09-22
[58] GMAC-SAIC: “Presentation for Third Parties”, 2006-04-06, slide 13
[59] GMAC-SAIC: “Presentation for Third Parties”, 2006-04-06, slide 17; Levis, D. (Credit Manager, GMAC-SAIC). Notes taken during the interview, Shanghai, 2006-09-22
[60] Blank, Matthias (2006), “Autofinanzierungsgeschäft: Pionierarbeit in China”. *die bank*, Vol. 7, p. 39
[61] Serrado, Javier and Sabadell-Beijing, Banco (2003), “China’s Entry into the WTO and the Financial Sector”, p. 4
[62] GMAC-SAIC: “Presentation for Third Parties”, 2006-04-06, slide 18

Rental Companies

Car rental companies such as Hertz and AVIS offer a different product to the customers[63]. They have a leasing program where the interested parties can chose between the range of short rentals (3-6 months) to long term leases (24-36 months). After the expiration of this term the lessee can then purchase the vehicle[64].

Since this business is very similar to regular leasing contracts which are not allowed in China generally it is doubtful for how long the rental companies' special offers can endure.

[63] GMAC-SAIC: "Presentation for Third Parties", 2006-04-06, slide 17

[64] Hertz https://www.hertz.de/rentacar/byr/index.jsp?targetPage=AsiaLeasingProgram.jsp&leftNavUser Selection=globNav_3_5_7&region=Asia, last visited on 2006-11-13

3. Market Conditions

The market conditions in China are basically a set of legal requirements as well as the particular risks in that emerging market. Thus, these two aspects shall be discussed in the next section.

3.1. Legal requirements

This chapter will be concerned with the market conditions for the auto financing business that are mainly prescribed by the CBRC's regulations. Therefore, I will look at the Administrative as well as the additional Implementing Rules for AFCs in China.

The following paragraphs thus deal with both a selection of the three most important and controversial regulations which car loan companies are confronted with. On this basis I will make clear the resulting market conditions for AFCs.

3.1.1. Important Administrative Regulations

Before the CBRC had released its regulations for the car financing market on October 3rd, 2003[65], AFCs could not apply for a business licence due to the lack of a legal basis.

The rules' intentions are to comply with the WTO terms and to open up the Chinese financial market to foreign AFCs. On the other hand, the CBRC wants to regulate these companies' business activities and to secure the market's legal certainty[66].

The Administrative Regulations consist mainly of five fields:

Chapter 1: General provisions for the rules' aims; the AFCs' task; and the CBRC's authority over car financers.

Chapter 2: Regulations and requirements for the establishment of a company; procedure in case of changes (company name, organisational structure, upper management, and termination).

Chapter 3: The legal scope of an AFC; supervision of management.

Chapter 4: Legal liabilities regulate AFCs offences against the Administrative Rules; also given are possible punishments/fines for such illegal behaviour.

[65] CBRC (2003), "*Administrative Rules Governing the Auto Financing Company*", China Banking Regulatory Commission No. 4 Order, Beijing, p. 1

[66] CBRC http://www.cbrc.gov.cn/mod_en00/jsp/en004002.jsp?infoID=246&type=1, last visited on 2006-11-17

Chapter 5: Supplementary provisions emphasise the rules' validity also for AFC incorporations that receive fundings by either Hongkong or Macao special administrative region, or Taiwan province[67].

Of particular importance here are three restrictions which AFCs are not quite satisfied with.

RMB 500 mio. minimum capital

The first inconvenience is seen in the requirement of article 7. It prescribes a minimum registered capital of RMB 500 mio. to establish an AFC in China[68]. This amount is so high that only AFCs with financially strong investors are welcomed by the Chinese state. But even for companies like VWFS and GMAC it means a significant financial effort. Even if they are allowed to use this capital for allocation of car loans, many contracts are necessary to use their money at full volume. That is AFCs' equities exceed the actual necessary need for this business[69].

$$ROE = \frac{net\ income}{equity}$$

Figure 4: Return on equity[70]

Accordingly, the AFCs' return on equity (ROE) is low. The ROE is the ratio between the net income of a company at the end of a year and its equity. It is thus a helpful tool to find out more about a company's profitability and to compare it to that of other enterprises in the same business[71]. So due to the high prescribed equity capital the AFCs' profitability will be low within the first years after market entry.

[67] CBRC (2003), "*Administrative Rules Governing the Auto Financing Company*", China Banking Regulatory Commission No. 4 Order, Beijing, pp. 1-11
[68] CBRC (2003), "*Administrative Rules Governing the Auto Financing Company*", China Banking Regulatory Commission No. 4 Order, Beijing, p. 3
[69] Levis, D. (Credit Manager, GMAC-SAIC). Notes taken during the interview, Shanghai, 2006-09-22
[70] Own illustration
[71] Schmolke, Siegfried, Deitermann, Manfred and Rückwart, Wolf-Dieter (1999) *Industrielles Rechnungswesen – IKR; Finanzbuchhaltung, Analyse und Kritik des Jahresabschlusses, Kosten- und Leistungsrechnung; Einführung in die Praxis*, Darmstadt: Winklers Verlag, p. 336

Capital adequacy ratio less than ten percent

The next constraint is that car financing companies' capital adequacy ratio is supposed to be at least ten percent in order to meet the capital to risk assets ratio[72]. In other words, AFCs in China are allowed to accumulate debts worth ten times of their equity.

$$DER = \frac{fixed\ liabilities}{shareholders'\ equity} < 10\%$$

Figure 5: Debt/equity ratio[73]

Thus, the debt/equity ratio (DER) is the index for measuring the operational risk by putting liabilities in relation to equity. The more fixed liabilities are signed for certain equity capital the riskier the business gets. Nevertheless, the higher the ratio and the resulting risk get the higher might be the possible dividend-payout to the shareholders[74]. Since this ten to one ratio is very low AFCs face big expenditures and efforts while the according low profit margins do not conform to their wishes.

Exclusion of leasing

Even if the aim of this thesis is not to look at car leasing it should be briefly noticed that it is not explicitly forbidden for AFCs to sell leasing contracts but the CBRC neither gave them the permission to offer this kind of service[75]. Leasing is a hire-purchase programme where the customer pays monthly rents for using the car[76] for 12 to 60 months[77]. After expiration of the contract the lessee can chose if he wants to pay off or return the vehicle. Another option is to lease a new car[78].

In other countries, AFCs offer the so-called "full service leasing" where insurance, inspections, oil changes, MOT tests, etc. are included in a package which is very convenient

[72] CBRC (2003), "*Administrative Rules Governing the Auto Financing Company*", China Banking Regulatory Commission No. 4 Order, Beijing, pp. 7,8
[73] Own illustration
[74] WebFinance http://www.investorwords.com/1316/debt_equity_ratio.html, last visited on 2006-11-17
[75] CBRC (2003), "*Administrative Rules Governing the Auto Financing Company*", China Banking Regulatory Commission No. 4 Order, Beijing, p. 7
[76] Zeuke, Peter (1998) *Das 1x1 der Autofinanzierung; So entscheiden Sie richtig: Barzahlung, Kreditkauf oder Leasing*, Düsseldorf und München: Econ, pp. 65, 68
[77] VW Bank http://www.volkswagenbank.de/index.php?ftu=864851b3e2283bd15bccd050b0be0ac3&tr=pk&id=911&type=110&backPID=911&tx_faq_faq=52, last visited on 2006-11-18
[78] VW Bank http://www.volkswagenbank.de/index.php?ftu=864851b3e2283bd15bccd050b0be0ac3&tr=pk&id=911&type=110&backPID=911&tx_faq_faq=51, last visited on 2006-11-18

for the customers[79]. Through this programme AFCs would have a great advantage since they could distinguish themselves from banks in China. Indeed, banks could also offer insurances but never maintance works.

Since the competition on the car financing market is supposed to be carried out through the service this situation is painful for financing companies as it limits their abilities to enter a further profitable business[80].

3.1.2. Important Implementing Regulations

Functioning as a manual for the Administrative Regulations the CBRC also issued the Implementing Rules. They are also divided into five chapters which deal with mainly two topics.

The first part is concerned with the whole procedure of establishing an AFC including the process of permission. Moreover, it gives requirements for personal qualifications for the upper mangement, their tasks, assessment of performance, and also layoff conditions. The final point regards the authorisation set-up[81].

The second part gives information about risk control and the supervision by the CBRC over the car financing companies. It is particularly controlled if AFCs are in compliance with the rules as well their operational risk[82]. To explain why this part is highly important to AFCs one example of a controversial issue comes next.

Limited oustanding loans

Article 41 states that AFCs' outstanding loans to a single customer must not exceed 15 percent of the car financial companies' equity in the amount of RMB 500 mio[83] in order to limit the payment risk of a major borrower. In case such a super deal would bounce and the respective financing company lost a big sum of money it might leave the market. This might be a general loss in economic, social, and political issues. The CBRC therefore wants to limit the risk of losing such a good company[84].

79 VW Bank http://www.volkswagenbank.de/index.php?ftu=864851b3e2283bd15bccd050b0be0ac3&id =5&nt_sr=4, last visited on 2006-11-18
80 Levis, D. (Credit Manager, GMAC-SAIC). Notes taken during the interview, Shanghai, 2006-09-22
81 CBRC (2003), „Implementing Rules for the Administrative Rules Governing the Auto Financing Company", Beijing, pp. 38-46
82 CBRC (2003) „Implementing Rules for the Administrative Rules Governing the Auto Financing Company", Beijing, pp. 46-50
83 CBRC (2003) „Implementing Rules for the Administrative Rules Governing the Auto Financing Company", Beijing, p. 48
84 Levis, D. (Credit Manager, GMAC-SAIC). Notes taken during the interview, Shanghai, 2006-09-22

However, the CBRC also tries to spread market shares of major clients amongst their state-owned banks and not to leave this business to AFCs only.

Since financing companies' try to finance their dealers' over-capacities this article means a drastic restriction because in that case not single cars but fleets might be financed. Occasionally, the credit level could be exceeded then.

Neither VWFS nor GMAC wanted to reveal specific ideas how to circumvent this problem. But a common technique is to split the demanded credit volume for a certain car fleet onto more than one borrower[85]. Another possible idea is to increase the company's equity[86]. That is AFCs already found solutions to take the wind out of the CBRC's sails.

Prescribed interest rates

If AFCs want to borrow money from other banks they can get this only at the interest rate prescribed by the CBRC. The same goes for extensions of loans to customers. Here car credits are only allowed to be given out at the PboC's rate[87]. The alteration rate here is ten percent below that figure whereas upwards is no limitation any longer[88].

The problem with that fixed rate is AFCs and their distributors are restricted in the formal arrangements of their sales strategies. That is they cannot increase car sales by lowering the annual percentage rate (APR).

Additionally, the competition between financing companies and banks is slowed down due to an almost identical APR amongst the competitors. Therefore, it is a common practise for Chinese banks to make special concessions to customers on an illegal level[89]. These so-called "kickback" businesses are illegal. Thus AFCs must not dare to join these methods.

To remain competitive international car financers thus need to differ through the quality and offers of their financial services. More, car prices should be considered, too.

3.2. The risks in this emerging market

There exist many uncertainties and risks in the car financing market. I will here give an overview of possible problems that might occur so that one can better understand the problems that AFCs are confronted with in China.

[85] Wirtz, R. (Sales Department Consultant, VWFS). Notes taken during the interview, Beijing, 2006-09-26
[86] Levis, D. (Credit Manager, GMAC-SAIC). Notes taken during the interview, Shanghai, 2006-09-22
[87] CBRC (2003), „Implementing Rules for the Administrative Rules Governing the Auto Financing Company", Beijing, p. 49
[88] Levis, D. (Credit Manager, GMAC-SAIC). Notes taken during the interview, Shanghai, 2006-09-22
[89] Wirtz, R. (Sales Department Consultant, VWFS). Notes taken during the interview, Beijing, 2006-09-26

Thus the following paragraphs will examine troubling issues in more detail. However, VWFS and GMAC emphasise that their major competences especially lie in risk management[90].

3.2.1. Relationship between distribution partners and auto financing companies

Cars are sold only by car dealers who therefore possess an important position. In order to sell the vehicles at a maximum profit AFCs support their dealers in the end customer business by financing their cars.

Of course, distributors want to maximise their profit margins, too. Thus they also try to find cheaper deals with state-owned banks which heats up the competition. That is the dealer itself is a risky customer in the whole car sale process due to the lack of loyalty[91].

However, dealers have a big advantage if they do their business with an AFC. After the contract is concluded the dealer has not to bear the risk with the end customer but it is passed onto the car financer. This is not possible with banks. Here the dealer is in the bank's debt. Obviously, distributors are more interested in a deal with AFCs[92].

Besides that, the customer has little incentive to ask for a credit at a state-owned bank because from the finance company he can get all services he wants in a one-stop-shopping[93]. That includes registration, insurance, maintenance, and more.

A further reason why car dealers often prefer cooperation with AFCs is the provision of suitable IT-systems on their part[94]. That fosters both a good customer loyalty and reduces the process time for a credit application and the commitment can be made faster. Banks still need a two day period to decide whether a credit is granted or not due to missing creditworthiness records on part of the customers[95].

AFCs also send out "account managers" to dealers to train employees on the job. At VW car shops works at least one employee who is introduced to the offered financial services and its appropriate necessary procedures[96].

[90] Levis, D. (Credit Manager, GMAC-SAIC). Notes taken during the interview, Shanghai, 2006-09-22; Wirtz, R. (Sales Department Consultant, VWFS). Notes taken during the interview, Beijing, 2006-09-26
[91] Levis, D. (Credit Manager, GMAC-SAIC). Notes taken during the interview, Shanghai, 2006-09-22
[92] Wirtz, R. (Sales Department Consultant, VWFS). Notes taken during the interview, Beijing, 2006-09-26
[93] Wirtz, R. (Sales Department Consultant, VWFS). Notes taken during the interview, Beijing, 2006-09-26
[94] Levis, D. (Credit Manager, GMAC-SAIC). Notes taken during the interview, Shanghai, 2006-09-22
[95] Gross, U. M., (Marketing Consultant, VWFS). Notes taken during the interview, Beijing, 2006-09-26
[96] Wirtz, R. (Sales Department Consultant, VWFS). Notes taken during the interview, Beijing, 2006-09-26

Last-mentioned, car dealers also receive provisions in the form of money and other incentives such as journeys, tickets for sport events, etc.[97]. Whereas the former is more seen as a bonus program, the latter is supposed to increase emotional ties with AFCs.

3.2.2. Selection of a sound range of customers

AFCs in China select proper customers by looking into their creditworthiness. They want to find out if credit users are able to pay back the instalments or not. After the rating customers are divided into three degrees of creditworthiness. The first includes the good and financially strong individuals. The second group consists of qualified and doubtful borrowers who need to bring in additional documents to qualify for a contract because the first rating was not sufficient enough. The third category contains debtors who do not pass the rating because they would not be able to pay the instalments or are on a blacklist already. Their applications for a loan are turned down and thus they are denied a credit[98].

Granted	Qualified	Denied
• Good customers • Solvent • Quick rating	• Doubtful customers • Maybe insolvent • Checked thoroughly • Additional documents necessary	• Denied borrowers • Insolvent • On blacklist

Figure 6: Rating of creditworthiness[99]

But how can AFCs make sure they have only good customers? To figure this out one needs to scrutinise their methods for private and business borrowers.

Private customers

Since September 2005 China tries to implement a sound rating system like in other countries where credit information is collected and can be scanned[100]. But so far this data base is not working properly and does not provide sufficient nor satisfactory information[101].

[97] Gross, U. M., (Marketing Consultant, VWFS). Notes taken during the interview, Beijing, 2006-09-26
[98] Wirtz, R. (Sales Department Consultant, VWFS). Notes taken during the interview, Beijing, 2006-09-26
[99] Wirtz, R. (Sales Department Consultant, VWFS). Notes taken during the interview, Beijing, 2006-09-26; Gross, U. M., (Marketing Consultant, VWFS). Notes taken during the interview, Beijing, 2006-09-26
[100] PBoC http://www.pbc.gov.cn/english//detail.asp?col=6800&ID=61&keyword=credit, last visited on 2006-11-21

Nevertheless, AFCs are still working on their own “gathering information process”[102] for their own goods and because it is prescribed by the “Administrative Rules for Automotive Loans”[103]. In these expert scorings[104] customers are asked to provide information about themselves. These include housing, age, marital status, occupation, income, as well as fixed expenditures and credits[105].

These data sets are filed and saved on credit institutes’ “score cards” as well as in the PBoC’s database[106]. On the basis of these records AFCs can correlate diverse specifications to each other and thus calculate a probability index of the credit risk.

That system still needs to be improved since temporary it serves more as a measurement to exclude black sheep and to set up a blacklist than as a rating method[107].

Mistakes will continue to occur with defining and seperating customers into the appropriate categories. But this is inevitable and AFCs see it as vital to learn more about the assessment of Chinese private customers’ creditworthiness[108].

Business customers

When it comes to business customers the rating proves to be a bit easier and more precise because the car financers can see through the companies’ balance sheet. Due to long-term experience international AFCs are able to recognise whitewashed weak points. So they can come to reliable scorings[109].

Granted and denied applicants can be figured out without problems. Whereas it is more difficult to distinguish the second group. That situation is a big issue because business customers mostly order a whole fleet of cars, and in case of dealers a whole stock of cars needs to be financed. Therefore it would be more costly to compensate for the loss if the customer turns out to be unable to pay back the credit than it is in the case of private borrowers who finance only one vehicle.

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[101] Wirtz, R. (Sales Department Consultant, VWFS). Notes taken during the interview, Beijing, 2006-09-26
[102] Levis, D. (Credit Manager, GMAC-SAIC). Notes taken during the interview, Shanghai, 2006-09-22
[103] PBoC http://www.pbc.gov.cn/english//detail.asp?col=6800&ID=19&keyword=database, last visited on 2006-11-21
[104] Blank, M. (ibid.), p. 38
[105] Levis, D. (Credit Manager, GMAC-SAIC). Notes taken during the interview, Shanghai, 2006-09-22; PBoC http://www.pbc.gov.cn/english//detail.asp?col=6800&ID=19&keyword=database, last visited on 2006-11-21
[106] PBoC http://www.pbc.gov.cn/english//detail.asp?col=6800&ID=19&keyword=database, last visited on 2006-11-21
[107] Wirtz, R. (Sales Department Consultant, VWFS). Notes taken during the interview, Beijing, 2006-09-26
[108] Blank, M. (ibid.), p. 38; Wirtz, R. (Sales Department Consultant, VWFS). Notes taken during the interview, Beijing, 2006-09-26
[109] Levis, D. (Credit Manager, GMAC-SAIC). Notes taken during the interview, Shanghai, 2006-09-22

Like the same for individuals' loans, AFCs can also gather additional information for institutional and dealers' loans from the central data bank of the PBoC in Shanghai where all company credits must be registered[110]. There creditors at least can find out how many open credits the debtor still needs to repay.

Therefore, credit institutes will be eager to especially finance their dealers' cars since it is safer and supports the sales of the own brand.

3.2.3. Risk limitation due to intelligent credit design

AFCs can reduce losses due to payment risk through two parameters: amount of first instalment and credit period[111].

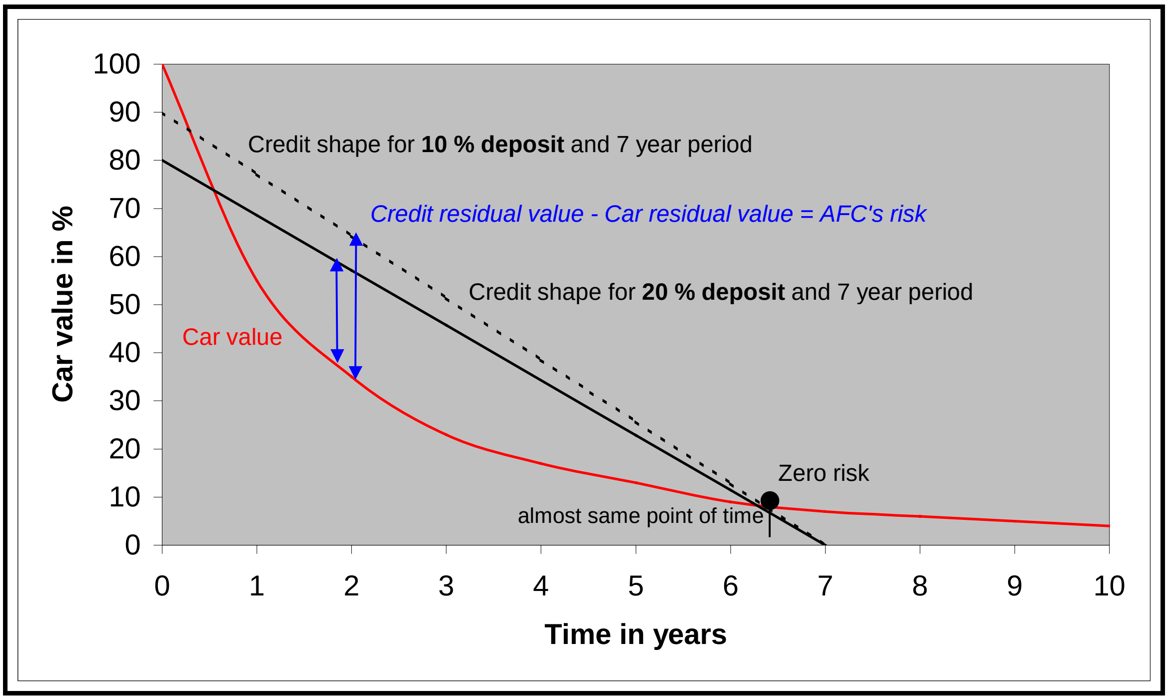

Figure 7: AFCs risk minimisation related to first instalment[112]

In case the debtor is unable to pay the monthly instalments the car is repossessed and then sold by the creditor. This amount realised is then used to compensate for the outstanding residual debt. Due to degressive fall of value within the first months cars' worth is at that point mostly lower than the outstanding credit which is reduced linearly by fixed rates. Thus AFCs make a loss which can be minimised as shown next.

[110] PBoC http://www.pbc.gov.cn/english//detail.asp?col=6800&ID=19&keyword=database, last visited on 2006-11-21
[111] Levis, D. (Credit Manager, GMAC-SAIC). Notes taken during the interview, Shanghai, 2006-09-22
[112] Own illustration

Amount of first instalment

The higher the first instalment the lower is the difference between outstanding sum and a car's residual value. That is the risk is reduced by the extent of the arising loss of the cross trade.

The risk is at zero as of the amount of the unpaid instalments are align with the car's residual value. The problem here is that one can hardly antedate this point of time by increasing the first instalment.

However, higher deposits also have a second benefit. The customer will appreciate the car more and is more interested to redeem the loan. Therefore, VWFS set their first instalments on 20 to 30 percent of the purchase price[113]. Indeed, this measurement reduces the risk but it also cuts down an AFC's profit.

Credit period

If car financers shorten the credit period as much as possible they might experience two positive effects. First, the difference between the open credit and the car's residual value is reduced. Second, they also can antedate the point of time where the auto's value is equivalent to the outstanding credit and the risk is quasi eliminated[114].

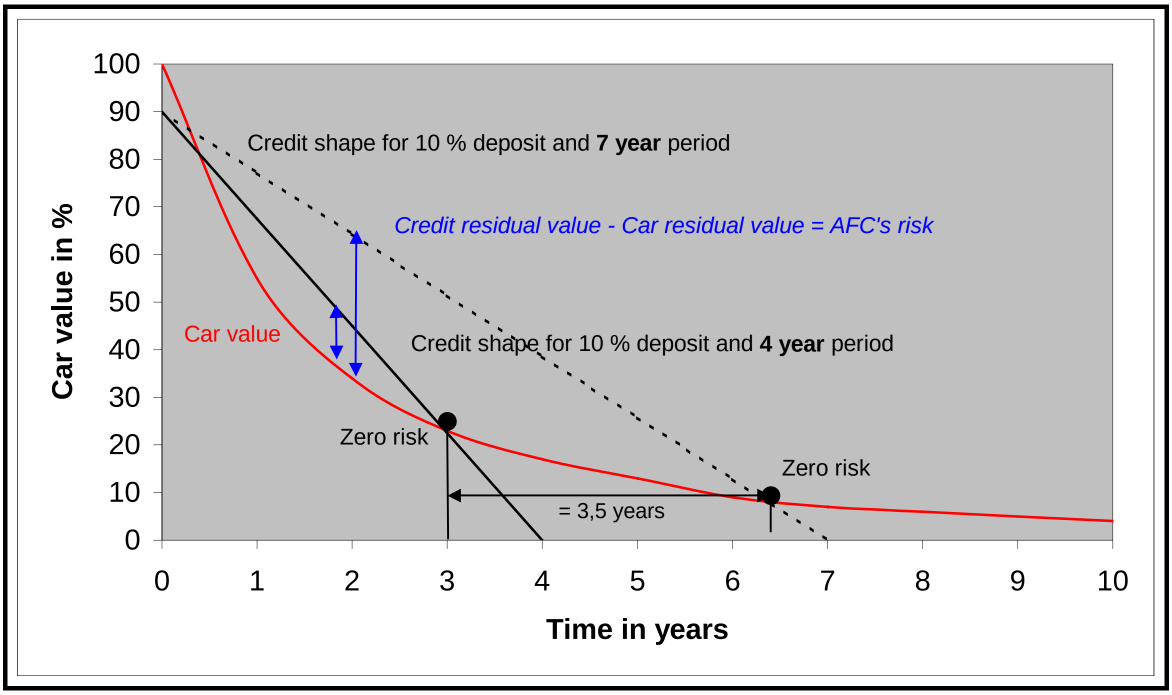

Figure 8: AFCs risk minimisation related to credit period[115]

[113] Wirtz, R. (Sales Department Consultant, VWFS). Notes taken during the interview, Beijing, 2006-09-26
[114] Wirtz, R. (Sales Department Consultant, VWFS). Notes taken during the interview, Beijing, 2006-09-26
[115] Own illustration

Short credit periods mean higher monthly instalments for customers. Thus, mainly people with better incomes are attracted. This also reduces the risk.

Combination of high deposit and short credit period

In order to minimise the risk both measurements are combined. That means a first instalment of 20 to 30 percent of the car's value and a preferably short credit period of three to five years.

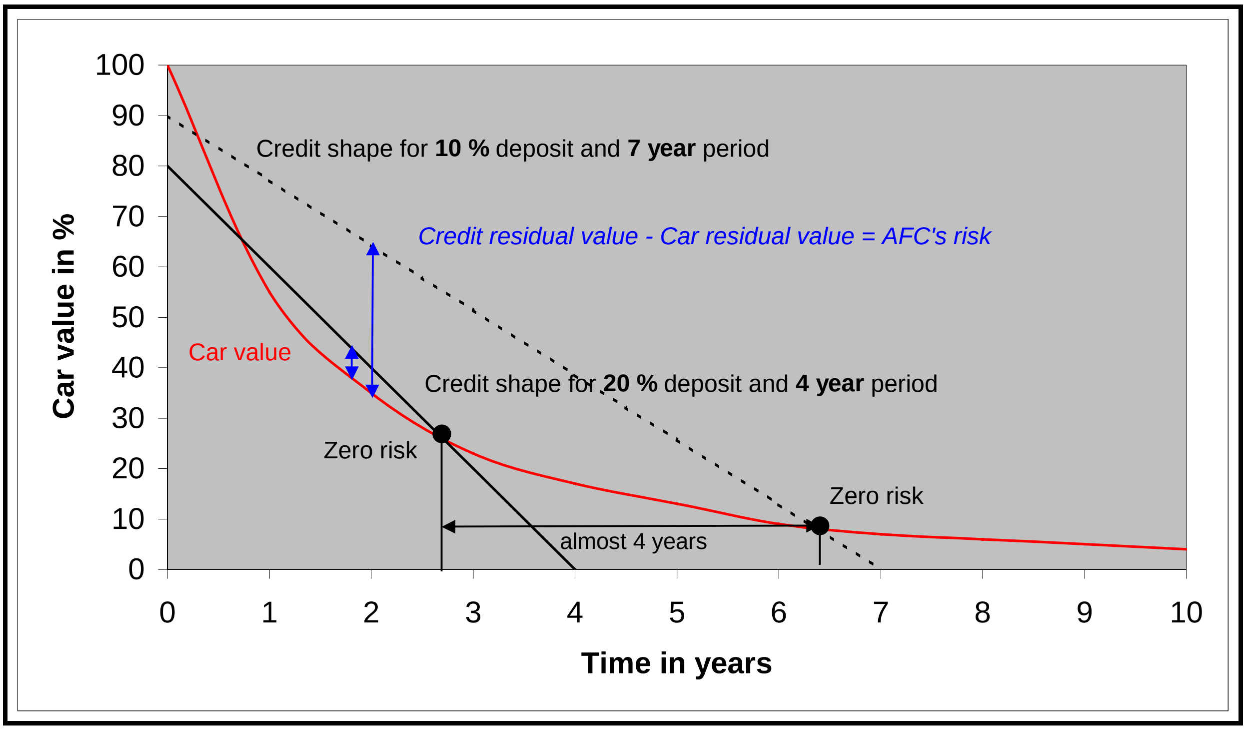

Figure 9: AFCs optimal risk minimisation[116]

This is optimal for AFCs but it is a higher financial burden for the customers. Thus for them it is not optimal in price.

Since Chinese state-owned banks do not pursuit risk management in the way AFCs do, they can often undercut prices and due to their Guanxi network offer deposits at just 10 percent even if they are legally bounded to 20 percent, either[117]. Therefore, car financing companies need to stand out against these competitors by offering superb services.

[116] Own Illustration

[117] Wirtz, R. (Sales Department Consultant, VWFS). Notes taken during the interview, Beijing, 2006-09-26

3.2.4. Missing types of bank transfers

Credit instalments need to be collected. VWFS and GMAC emphasise that this field is one of their core competences which is conducted by themselves[118]. The reason why this section is not outsourced to their dealers is simple. AFCs want to gain more experience about risks in the market through closeness to this business and observation. Nevertheless, distributors hold a supportive role as they have closer contact to customers[119]. GMAC claims to have a zero NPL ratio so far[120].

The problem with debt collection is the lack of a proper logistic system for bank transfers from one institute to another. That means it is sometimes difficult for AFCs to get a direct debit authority from their customers which is the most common practise in further developed countries to collect payments[121].

At the moment, customers can only choose between certain banks that cooperate with the respective car financer. So AFCs can do transfers within the network of one bank. For the customer itself it would not be a big deal to find an institute since there exists an enormous branch density in China, especially in major cities[122].

The disadvantage for AFCs is they are dependent on Chinese banks. However, VWFS and GMAC make clear that a possible customer must have a bank account. Otherwise he will not be granted a credit[123].

3.2.5. Credit protection in case of payment risk

Besides all risk prevention in the car financing business it happens that debtors are overdue with paying their instalments. In such cases VWFS and GMAC try to find an amicable arrangement with the client[124]. Thus, he receives calls and/or reminders are texted to the customer's mobile phone. Additionally, personal visits are common[125]. GMAC prefers the

[118] Levis, D. (Credit Manager, GMAC-SAIC). Notes taken during the interview, Shanghai, 2006-09-22; Wirtz, R. (Sales Department Consultant, VWFS). Notes taken during the interview, Beijing, 2006-09-26
[119] Wirtz, R. (Sales Department Consultant, VWFS). Notes taken during the interview, Beijing, 2006-09-26
[120] GMAC-SAIC: "Presentation for Third Parties", 2006-04-06, slide 6; Levis, D. (Credit Manager, GMAC-SAIC). Notes taken during the interview, Shanghai, 2006-09-22
[121] Wagner, Ami (1995) "*Money, Money… Von Autofinanzierung bis Zwangsvollstreckung*", München, p. 23
[122] Gross, U. M., (Marketing Consultant, VWFS). Notes taken during the interview, Beijing, 2006-09-26
[123] Levis, D. (Credit Manager, GMAC-SAIC). Notes taken during the interview, Shanghai, 2006-09-22; Wirtz, R. (Sales Department Consultant, VWFS). Notes taken during the interview, Beijing, 2006-09-26
[124] Levis, D. (Credit Manager, GMAC-SAIC). Notes taken during the interview, Shanghai, 2006-09-22; Wirtz, R. (Sales Department Consultant, VWFS). Notes taken during the interview, Beijing, 2006-09-26
[125] Wirtz, R. (Sales Department Consultant, VWFS). Notes taken during the interview, Beijing, 2006-09-26

handing over of the collateral to avoid time consuming processes at court[126]. But what kinds of collateral come into consideration?

Chattel mortgages

For example in Germany, AFCs secure their loans by chattel mortgages. Here one distinguishes between ownership and possession of property. The defaulting client transfers the ownership over the car to the car financing company by handing them its registration documents. That is the AFC is now the owner and the client still possesses the car[127].

If the customer continues not to pay his instalments he also must assign the property which is the car itself. The AFC then can sell this security to liquidate it.

But there is a rub in it. By now, in China exists no precise distinction between ownership and possession of property. Thus, it is highly unlikely that the chattel mortgage is followed by the assignment of property.

Car financers who want to use the car as collateral need to make sure they can get access to it. Furthermore, the vehicle must be fully covered so that AFCs get back possible losses in value due to accidents, damages or theft[128]. In case the client does not pay his instalments and the car is crashed the insurance pays compensation directly to the financing company[129].

If a customer is not cooperative and does not hand over the vehicle voluntarily AFCs need to locate and find the car before they can repossess it. But due to China's huge country size this is an almost hopeless endeavour[130].

However, when the car is repossessed it needs to be sold. This is mostly done by car dealers who cooperate with the respective financing company[131]. But it is still very difficult to sell second-hand cars on the Chinese market as its segmentation[132] still needs to be improved. By now, on every used car come two new ones[133].

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[126] Levis, D. (Credit Manager, GMAC-SAIC). Notes taken during the interview, Shanghai, 2006-09-22
[127] Müssig, Peter (1999) "*Wirtschaftsprivatrecht, Eine Darstellung für Studium und Praxis*", Heidelberg, p. 336
[128] ADAC http://www.adac.de/Search/SearchResult/RW_HighLight.asp?RWDoc2Show=37059&RWLang =de&RWCollectionID=adac&RWQuery=vollkasko&RWURL=http://www.adac.de/Versicherungen/Kfz_Versicherung/bausteine/vollkasko/default.asp&RWCookieValue=, last visited on 2006-11-24
[129] Levis, D. (Credit Manager, GMAC-SAIC). Notes taken during the interview, Shanghai, 2006-09-22
[130] Wirtz, R. (Sales Department Consultant, VWFS). Notes taken during the interview, Beijing, 2006-09-26
[131] Levis, D. (Credit Manager, GMAC-SAIC). Notes taken during the interview, Shanghai, 2006-09-22
[132] Segmentation here depends on the vehicles' age. Based on that cars are divided into different age classes.
[133] Levis, D. (Credit Manager, GMAC-SAIC). Notes taken during the interview, Shanghai, 2006-09-22

Development of market segmentation for Chinese second-hand cars is utterly important for AFCs. Through this market they are able to calculate appropriate repayment sums for vehicles and, consequently, proper residual values[134].

Land charges

In China also exists another form of loan security. If the car is secured by a land charge the customer is made accountable with transferring legal rights of use of his real property, such as buildings or freehold flats, to the finance company. The advantage here is that AFCs can easily find out the property's location and assert their rights to use. Compared to the problems one has detecting a mobile car this method is able to reduce the risk to secure loans. However, the necessary entries in the land register[135] are costly and time consuming. Therefore, AFCs use land charges only in individual cases and will not generalise them[136].

Residual debt insurance

Moreover, a residual debt insurance can secure the credit by paying the remaining debts directly to the financing institute in case of the debtor's death, disablement, and considerable illness[137].

But this type of credit coverage is not welcomed by AFCs anymore because many insurance frauds were committed in recent years[138]. Debtors could not pay back their liabilities and thus faked an event which was covered by their insurances in order to cash the amount insured[139]. Consequently, insurers withdrew from that market and residual debt insurances are not offered any longer[140].

Furthermore, debt insurances consume a lot of time to take out because the insurer has to accept the application first. And this prolongs the whole procedure until a car loan is conducted. This is not AFCs' intention since they want to keep the necessary effort and time as low as possible to minimise costs[141].

That is why car financers prefer the chattel mortgage of the vehicle for securing their credit risks as it proves to be the best option available even if property rights still need to be

[134] Levis, D. (Credit Manager, GMAC-SAIC). Notes taken during the interview, Shanghai, 2006-09-22
[135] Müssig, P. (ibid.), p. 347
[136] Levis, D. (Credit Manager, GMAC-SAIC). Notes taken during the interview, Shanghai, 2006-09-22
[137] VW Bank http://www.volkswagenbank.de/index.php?ftu=d0f0b3cb582e53691ef345fb57a1a833&nt_sr =11&kp=allInc2&pts=116435450758&id=finanzangebote, last visited on 2006-11-24
[138] Levis, D. (Credit Manager, GMAC-SAIC). Notes taken during the interview, Shanghai, 2006-09-22
[139] Blank, M. (ibid.), p. 36
[140] Levis, D. (Credit Manager, GMAC-SAIC). Notes taken during the interview, Shanghai, 2006-09-22
[141] Levis, D. (Credit Manager, GMAC-SAIC). Notes taken during the interview, Shanghai, 2006-09-22

defined and clarified. And so if not all risks can be eliminated, they can at least be limited at such a level AFCs are able to compensate them with their provisions for losses[142].

[142] Levis, D. (Credit Manager, GMAC-SAIC). Notes taken during the interview, Shanghai, 2006-09-22

4. Analysis of strengths and weaknesses for AFCs in comparison with the “Big Four”

In the following passage is conducted a strengths and weaknesses analysis of the Chinese car market. Therefore, I focussed on nine aspects which I compared between AFCs and state-owned banks. The analysis will look at:

- Experience
- Motivation
- Cost accounting
- Services
- Prices
- Communication
- Dealers
- Organisation
- Staff

Every single point can be assessed as very good, average, and very bad whereas the classifications have sliding transisitons amongst each other.

AFCs and the “Big Four” are confronted with these category groups so that one can easily draw a comparison between the two major competitors on the Chinese car financing market. If a competitor comes off obviously better than the other in certain categories it is a definite strength and might therefore mean a competitive advantage. But if one player comes off significantly worse that is assessed as a weakness and thus might constitute a competitive disadvantage in this business field.

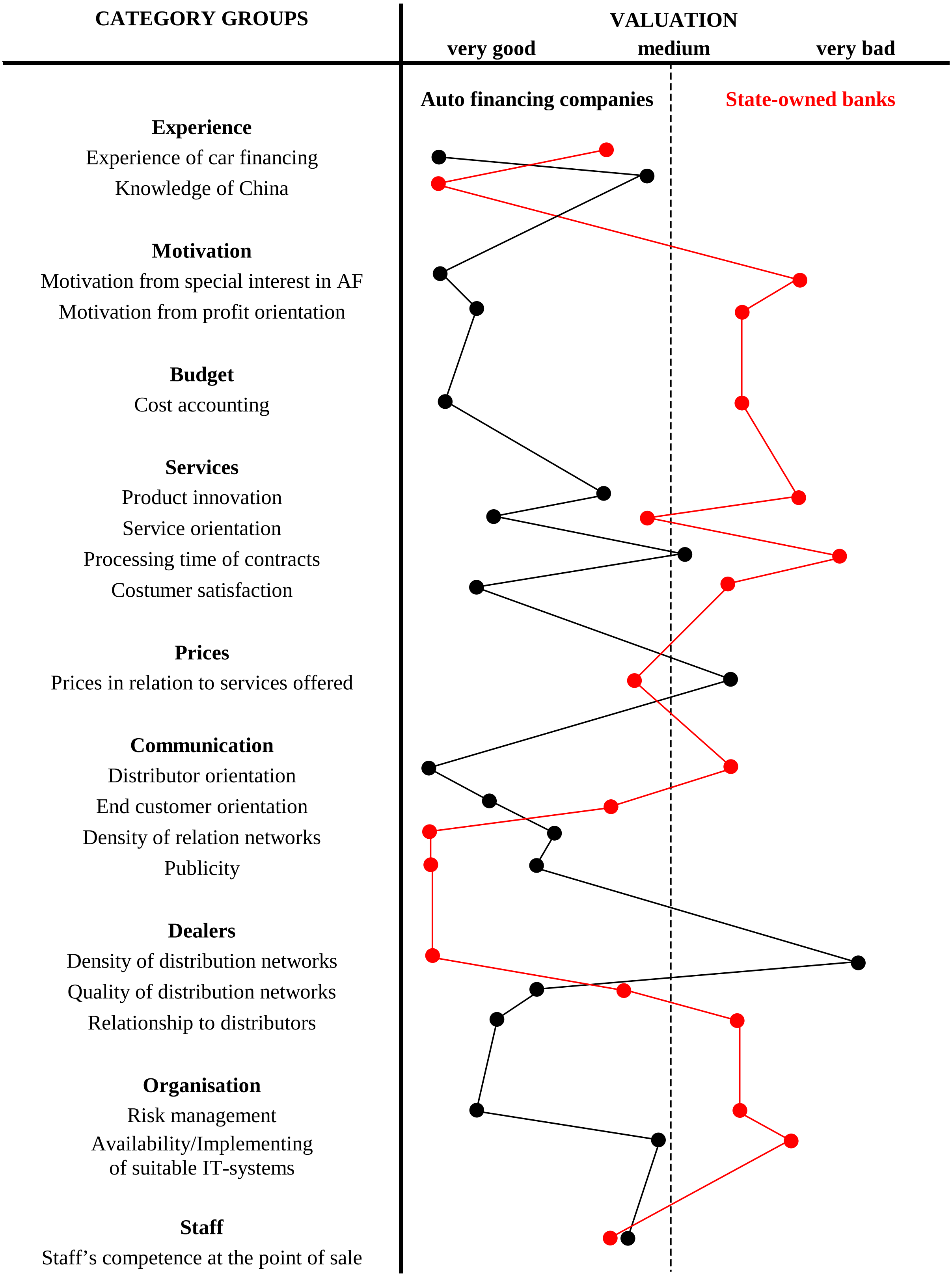

Figure 10: Comparison of strengths and weaknesses between AFCs and "Big Four"[143]

[143] Own illustration following Meffert, Heribert (2000) "*Marketing: Grundlagen marktorientierter Unternehmensführung*", Wiesbaden, p. 67; contents based on questionnaires conducted during interviews with

Experience

The first category group deals with the experience. It is divided into two sub-categories from which the first one is experience of car financing in general. AFCs get a very good score here due the long-time expertise in their core business. They can compare the Chinese market to other international locations and settings where they operate. Therefore, AFCs have developed an effective risk management. This actually compensates for their average knowledge of China. Since they were allowed only two years ago to operate in the Chinese car financing market AFCs still need to gain more information about this different country and its characteristics[144].

The state-owned banks instead have an excellent knowledge of the Chinese credit business and its customers. Thus they got an very good rating for that category which means a competitive advantage against the background of the high market risk that exists without having sufficient expertise of the particular country.

Nevertheless, the "Big Four" have deficits in the auto financing business itself because they started to participate in that field only eight years ago. Thus they cannot rely on any other experiences.

It seems as if AFCs are in the position to partly counterbalance their disadvantage of China knowledge through their experiences in the car financing business[145].

Motivation

In 2005, car loans, mortgages, and education loans made up 11% of the total bank lending in China[146]. That shows that state-owned banks' car financing business has only a small share in the whole credit portfolio. Not surprisingly, the motivation from special interest in the auto financing business is rather low compared to the share in car loans of AFCs. Car financers pursuit a different strategy. They are almost solely orientated to financing cars. Thus AFCs take the lead in this category.

When it comes to motivation from profit orientation both competitors are different, too. AFCs see profit maximisation as their first priority. Whereas the "Big Four" also want to earn money but they are not dependent on big profits due to the government's subsidies. So

Levis, D. (Credit Manager, GMAC-SAIC). Shanghai, 2006-09-22, Gross, U. M., (Marketing Consultant, VWFS) and Wirtz, R. (Sales Department Consultant, VWFS). Beijing, 2006-09-26

144 Levis, D. (Credit Manager, GMAC-SAIC). Notes taken during the interview, Shanghai, 2006-09-22

145 Gross, U. M., (Marketing Consultant, VWFS). Notes taken during the interview, Beijing, 2006-09-26

146 Unknown (2005), "China's banking industry: A great big gambling game", *The Economist*, Vol. 377, No. 8450, p. 78

the car financing business is not vital to them. Here again, car financers have a competitive advantage.

Budget

In order to assess the budget it is a good idea to look at the cost accounting and its performance. AFCs will have to budget very responsible because their profits in China are still very low compared to other countries. Due to a strict cost accounting AFCs can perform very well on this market and thus get a very good rating.

The state-owned banks instead are still not very concerned about their budget since they regularly get new cash injections from the government[147]. Another negative aspect comes to mind if one just looks at the extremly high density of banks' branches including all the staff members. That is unstainable without governmental support. That is why the "Big Four" only get a low average score.

Nevertheless, due to these distorted market mechanisms and conditions state-owned banks still have the advantage over AFCs even if the latter follows the more efficient approach.

Services

The characteristics of services for financing cars on the Chinese market are product innovation and service orientation, processing time of contracts, and consumer satisfaction. AFCs' product innovation is very good even if only well-known products from overseas are sold[148]. But they offer additional services packages as described above in form of "one-stop-shopping" which is completely new for Chinese customers. VWFS also offers balloon financing where the customer pays reduced monthly instalments and has a bigger final payment[149].

On the other hand, car financers are not allowed to offer leasing contracts which limits their product portfolio. So they cannot differ as much as possible from state-owned banks. Thus they get no top rating here.

For the "Big Four" car loans are new innovative territory but it is offered in basic versions only which might come along with rudimental insurance packages. This is new but not inventive. Instead, most services are merely copied from AFCs' service range.

[147] Unknown (2005), "China's banking industry: A great big gambling game", *The Economist*, Vol. 377, No. 8450, p. 77
[148] Levis, D. (Credit Manager, GMAC-SAIC). Notes taken during the interview, Shanghai, 2006-09-22
[149] Gross, U. M., (Marketing Consultant, VWFS). Notes taken during the interview, Beijing, 2006-09-26

Service orientation is most crucial to auto financers as already mentioned. Services are not only focussed on end customers but more orientated to their dealers who then negotiate with the prospects[150]. In that sense the processing time of credits plays an important role and is a good factor to measure customer satisfaction. New IT solutions are supposed to accelerate the applications. But logistic problems and a bad information infrastructure still persist and so no big improvement can be seen and thus the processing of credits still takes a lot of time because Chinese prefer working with letters and papers which can be stamped than with electronic mails[151].

However, so far AFCs services dominate state-owned banks' offers since they have a wider range of customised alternatives. Furthermore, banks still do not supply additional service packages but insurances. And they could never take up maintenance to their portfolio.

What matters is customer satisfaction to generate loyalty. AFCs see this point as one of their strengths. Of course, there are clients who complain about diverse issues. But this is often due to the fact that they do not know what to expect when they finance a vehicle for the first time[152].

At banks instead one gets a different picture. Customers complain mainly about too long processing times for their applications, bureaucratic obstacles, and insufficient services. All these deficits can be regarded as weaknesses and so AFCs are still better off. However, banks are catching up and will continue to challenge car financers.

Prices

This category is not AFCs' favourite. Their prices are high because of the high service level through which they want to differ from the "Big Four". Of course, the customer needs to pay more for a higher quality product. However, for Chinese relations AFCs scratch the upper price range[153].

State-owned banks can offer their products at a lower price level. Moreover, they increase their service level constantly. Therefore, the customer decides whether he accepts the higher prices for better services. In that case the banks' strength in price level is not an advantage. But if customers do not appreciate advanced services since they are more expensive, then AFCs' advantage in the service category might even turn into a weakness.

[150] Wirtz, R. (Sales Department Consultant, VWFS). Notes taken during the interview, Beijing, 2006-09-26
[151] Levis, D. (Credit Manager, GMAC-SAIC). Notes taken during the interview, Shanghai, 2006-09-22; Wirtz, R. (Sales Department Consultant, VWFS). Notes taken during the interview, Beijing, 2006-09-26
[152] Levis, D. (Credit Manager, GMAC-SAIC). Notes taken during the interview, Shanghai, 2006-09-22
[153] Levis, D. (Credit Manager, GMAC-SAIC). Notes taken during the interview, Shanghai, 2006-09-22

Communication

This group is separated into distributor orientation, end customer orientation, density of relation networks, and publicity. AFCs' business is mainly focussed on dealers and the support is their main task. Since dealers are their core customers and work at the front the communication is good. Account managers take care of distributors to foster the relationship between them and car financers. Thus they get a very good rating here.

The "Big Four" are not that orientated to dealers and thus are assessed on a low medium level. They catch up a bit when it comes to end customer orientation but are still worse than AFCs because those conduct a more progressive and efficient marketing[154].

Banks have better connections and contacts to authorities like PboC and CBRC due to a higher density of relation networks. The "Big Four" are established for decades and thus have contacts to all fields. For AFCs it is more difficult to establish these relationships and contacts but it is heavily improving because of their local representative offices' lobbying[155].

Publicity builds confidence on part of customers. Banks could establish their positive goodwill over the past whereas car financers just recently entered the market, comparatively. Thus state-owned banks still have an advantage. But it is very helpful that AFCs can offer their products via well recommended car dealers such as VW, GM, etc., and benefit from their image. Moreover, Chinese customers seem to gain more confidence by explaining them companies' histories[156]. Thus car financers will continue to spread their reputation.

Dealers

AFCs distribute their products via their dealers and the "Big Four" through their branches. Thus, the former have a great competitive disadvantage with their small density of distribution networks compared to the huge net of state-owned banks which contain several thousand branches nationwide. For example, the ICBC had 18,764 branches in 2005[157] whereas VWFS only has 140 coorperation partners in 25 Chinese cities in 2006[158] and GMAC has 300 dealers[159].

But car financers are directly represented by their dealers at the point of sale (POS). That means they can immediately offer customers the "one-stop-service" in addition to an

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154 Gross, U. M., (Marketing Consultant, VWFS). Notes taken during the interview, Beijing, 2006-09-26
155 Wirtz, R. (Sales Department Consultant, VWFS). Notes taken during the interview, Beijing, 2006-09-26
156 Wirtz, R. (Sales Department Consultant, VWFS). Notes taken during the interview, Beijing, 2006-09-26
157 ICBC http://www.icbc.com.cn/e_about/index.jsp?column=About%2BUs%3EBrief%2Bintroduction, last visited on 2006-11-29
158 Wirtz, R. (Sales Department Consultant, VWFS). Notes taken during the interview, Beijing, 2006-09-26
159 Levis, D. (Credit Manager, GMAC-SAIC). Notes taken during the interview, Shanghai, 2006-09-22

auto purchase. Indeed, banks also cooperate with car dealers but since they are pure credit institutes their motives and, thus, ties with vehicles are not as strong as they are with AFCs.

So car financers are able to compensate the weak density of distribution networks by good relations and ties to their dealers who speak the same language, are involved in the same business, and want to sell vehicles. To increase these foundations AFCs provide incentives and proper IT infrastructure to them. All these motivating aspects are missing at bank branches. Nevertheless, it should be mentioned here that AFCs partly face problems with implementing new processes at their dealers’ offices[160].

Organisation

For this category group I want to look at the parameters risk management and the availability/implementation of suitable IT-systems. The former is one of AFCs’ core competences[161] (see chapter 3.2.). It therefore gets a very good result. Risk mangament is supposed to be supported be appropriate IT-solutions. Unfortunately, “[i]t is impossible to just translate Western software into Chinese and then hope that everything works without any problems”[162]. So it is not a matter of availability but of the implementation[163].

State-owned banks have just recently started to adjust their risk management under the supervision of the CBRC. So are the “Big Four” advised to meet an 8 % capital ratio by 2007. Otherwise they will face sanctions by the supervisory power[164]. Additionally, new IT-systems are arranged whose implementation might take a long period. However, the pressure to improve the risk control is not as heavy as for AFCs. State-owned banks might fear restrictions in case of violation of CBRC provisions but the government would never let them go bankrupt.

I would not claim AFCs’ strength in risk management as an advantage but rather as a necessity to survive in the Chinese car financing market.

Staff

Customers demand competent staff at the POS to get profounded services. Therefore, AFCs train “loan officers” and “customer consultants” to provide that. But still there is a big gap

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[160] Wirtz, R. (Sales Department Consultant, VWFS). Notes taken during the interview, Beijing, 2006-09-26
[161] Gross, U. M., (Marketing Consultant, VWFS). Notes taken during the interview, Beijing, 2006-09-26
[162] Levis, D. (Credit Manager, GMAC-SAIC). Notes taken during the interview, Shanghai, 2006-09-22
[163] Wirtz, R. (Sales Department Consultant, VWFS). Notes taken during the interview, Beijing, 2006-09-26
[164] Unknown (2005), “China’s banking industry: A great big gambling game”, *The Economist*, Vol. 377, No. 8450, p. 78

between theory and practice when it comes to the operative execution in the dealers' offices as well as in front of customers[165].

The situation for bank employees might be a bit better due to their financial background. But it would be an exaggeration to speak of profound knowledge. Thus I would not see a clear competitive advantage for banks here.

Result

It is obvious that AFCs face a strong competitor in their core business. The "Big Four" may not be able to compete with every strength of car financers. But their advantages lie in very important categories such as prices and their very good contacts to authorities. The size of market shares will thus depend on customers' preferences whether in favour of lower prices or better services.

As the Chinese are well known for their canniness, customers will compare precisely who offers the cheapest products with best qualities. Moreover, it is no secret that banks will attract clients through their illegal and "kickback" businesses. These practices obviously undercut a fair price-competition. Banks are aware of the competition on part of the AFCs, especially their "one-stop-shopping" strategy. That is why they use and rely on their excellent relationship network. In doing so they indirectly influence the market conditions for the foreign institutes via the CBRC.

To sum up, competitive advantages will only become real advantages if the customers realise them and are willing to pay for it.

SWOT analysis

Based on the above strengths and weaknesses analysis of the internal factors I now combine these aspects with opportunities and threats in the car financing market, the external factors. My focus here is exclusively on AFCs. In the SWOT matrix one can find four possible combinations which might occur in theory for car financers.

The best case eventuates if strengths dominate weaknesses and opportunities rule threats. Thus an AFC can play off all its strengths and seize the opportunities in full range on the market. That is car financers will widen their circle of customers and offer them their services. Therefore, the sales are boosted heavily and car producers can increase their production capacities.

[165] Wirtz, R. (Sales Department Consultant, VWFS). Notes taken during the interview, Beijing, 2006-09-26

INTERNAL FACTORS EXTERNAL FACTORS	**Opportunities** • Market growth • Better contact to authorities • Government's interst in the car market • Pioneer status	**Threats** • competition with "Big Four" • strong ties between state and state-owned banks • legal limitations of businesses • payment risk on part of customers • low loyality of dealers • no proper database of customers' credits • country's size • high population size in cities • underdeveloped second-hand market
Strengths • experience of car financing • special interst in car financing • cost accounting • product innovation • service orientation • customer satisfaction • End customer orientation • Distributor orientation • Quality of distribution networks • Relationship to distributors • Risk mangement	Widen the circle of customers of car financing Induce and increase in capacity in automobile production	Increase lobbying for auto financing Widen circle of customers carefully step by step Car industry's capacity planning should consider a conditional increase in car sales due to car financing
Weaknesses • Knowledge of China • Processing time of contracts • Prices • Density of distribution networks • Availability/Implementing of suitable IT-systems • Staff's competence at the point of sale	Stick to existing small circle of customers of car financing Work on weaknesses Car industry's capacity planning should consider only a limited increase in car sales due to car financing	Stick to existing small circle of customers of car financing Intensified increase in lobbying for auto financing Work on weaknesses Car industry's capacity planning should consider only a limited increase in car sales due to car financing

Figure 11: SWOT Matrix for AFCs in China[166]

In the worst scenario the strengths become subject to weaknesses and threats prevail opportunitites. Due to the weak points AFCs cannot handle the risks in the market. That might happen if the payment morale of customers leaves a lot to be desired. If car financers do not recognise this payment risk because of missing experience and continue to choose a bad range of clients the business becomes a losing game and is hard to sustain. Auto manufacturers

166 Own illustration following Meffert, H. (ibid.), p. 67; contents based on questionnaires conducted during interviews with Levis, D. (Credit Manager, GMAC-SAIC). Shanghai, 2006-09-22, Gross, U. M., (Marketing Consultant, VWFS) and Wirtz, R. (Sales Department Consultant, VWFS). Beijing, 2006-09-26

cannot make more profits of car sales through car financing. That means AFCs must work on their weaknesses and intensify their lobbying for auto financing so that they can change market conditions.

The third option is that threats are superior but can mostly be outweighed by AFCs' strengths. Here a sound risk management could detect payment risks and thus reduce them. Neverthless, car financers still need to improve the lobbying for their business to gain new customers according to the risks. Car producers can also calculate with a small increase in car sales due to auto financing.

In the last combination the weaknesses dominate AFCs' potential but the opportunities are stronger than the threats. Thus, opportunities might not be exploited to auto financers' full possibilities but they can still stick to the small range of their customers. Here it is important to work on one's weaknesses to make most of the concrete chances in the market. For example, the marketing division is challenged when it comes to positive publicity. Otherwise customers will conclude a deal with one of the well-known state-owned banks.

The final chapter will summarise the above findings. Based on those, it gives an outlook for car financers' future in China.

5. Conclusions and forecast for the Chinese car financing market

This paper was concerned with prospective automotive financing in China. In that respect, several concepts and problems were outlined.

My major focus was put on foreign automobile financing companies. Based on their aims I tried to figure out if AFCs can achieve them under special circumstances such as the competition, the legal requirements, and the threats that are implied in the Chinese car financing market. Due my literature research and personal interviews with specialists from VWFS and GMAC I could follow their statements and discuss the above issues from both theoretical and practical points of view.

After I got my first overview of car financing in China by reading press articles and magazines I could design a questionnaire which was the basis of my interviews and also worked as a guide for writing this thesis.

It turned out that a suitable way of structuring this paper was to divide it into three parts:

- The actors in the Chinese market for automobile financing
- The market conditions for AFCs
- Analysis of strengths and weaknesses as well as opportunities and threats in the Chinese car financing market for foreign car financers

The first part dealt mainly with basic information about the automobile financing market in China. Furthermore, I described two of the biggest foreign AFCs which are VWFS and GMAC. Later, the aims of these two companies were explained by scrutinising their position in China. The outcome was that car financing is supposed to be a lucrative business field as well as a supportive measurement for auto manufacturer to increase sales and to enlarge market shares in China. That means higher profits for the entire company groups at the end of the business year.

Then the four state-owned banks were considered as the biggest competitors to AFCs. For a better understanding of the competition between them I talked about the temporary banking situation in China. Moreover, banks' aims were displayed, too. Two reasons for their interest in car financing could be revealed. First, their bad economic constitution and, second, their close connection to the government. Nevertheless, it came out that the “Big Four” hardly can fulfil all their aims.

The other described competitors on the Chinese auto financing market such as regional banks, foreign banks, and car rental companies are minorities and were thus not put into further consideration.

In the next chapter the market conditions were examined. Therefore, the legal requirements with the administrative rules and its corresponding implementing rules were looked at. In that sense, AFCs opinions about these regulations were demonstrated. Due to strict limitations and restrictions of the car financing business foreign car financers are not satisfied with them since the rules make it almost impossible to work profitably. But AFCs have no other choice than to accept them if they want to operate on the Chinese market.

Futhermore, possible risks for AFCs in that emerging market were shown and also car financers’ measurements how to avoid or minimise them due to sound risk management. Of particular importance here were a good relationship between distribution partners and AFCs, the selection of a sound range of customers, intelligent credit design, bank accounts and direct debit authorities, as well as credit protection in case of payment risk. However, there remain always residual risks but it is possible to reduce those.

Finally, I compared AFCs and state-owned banks’ internal factors to find out more about strengths and weaknesses. Afterwards these internal aspects were put against external factors in a SWOT matrix. That pointed out likely consequences for AFCs and the car producers. At the moment, the threats still outweigh the opportunities of AFCs. But they seem to be aware of that problem and try to assess the risks. In my interviews I got the impression that these institutions were very confident about mastering initial obstacles in the near future[167]. It is certainly more insecure for foreign AFCs to not invest in the Chinese car financing market than to face the existing risks.

Especially in China exist so many different risks and crucial factors for the success or failure that AFCs often are not in a postion to alterate or avoid them. A major responsibility is carried by the Chinese government. As long as they support the car industry all is supposed to work well also for foreign car financers. If not, this new business sector might be vanished into thin air as quick as it started to emerge.

That means one should be cautious with exaggerated hopes in the Chinese auto financing market as there are plenty of threats and the ongoing competition with state-owned banks is a fierce one. However, if AFCs are able to eradicate their weaknesses and as the

[167] Levis, D. (Credit Manager, GMAC-SAIC). Notes taken during the interview, Shanghai, 2006-09-22; Wirtz, R. (Sales Department Consultant, VWFS). Notes taken during the interview, Beijing, 2006-09-26

market conditions improve the way is clear for lucrative businesses. Nonetheless, the Chinese government will not tolerate state-owned banks to become the rear light of this accelerating growth machinery.

Car financing in China is a risky business especially due to the lack of property rights. However, it also involves great chances in the future. Trial and (hopefully not too many) error(s). That's probably foreign automotive financers' slogan.

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