

International Economics with a focus on China

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**The Chinese automotive industry:  
WTO accession, problems in going global and  
future potential**

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## **Abstract**

The Chinese economy has been growing with a pace and duration that the world has never seen before. Since 1978, the country has been facing a constant economic growth for more than 30 years. One of the pillars of the economy is the automotive industry; an interesting mixture of Joint Ventures and independent companies. The competition is cut throat and has even been more intense after the China's World Trade Organization accession in 2001. The potential of the industry is huge, taken into consideration the size of the market and the impressive growth of the economy. All the above leave no doubt: the WTO accession in 2001 was a very important evolution that could trigger many changes in the country's industry and potentially give the Chinese auto manufacturers the chance to go global and compete in Western, more prestigious markets but in the same time caused serious concern about the possible threats that it could cause.

The questions this paper will try to answer are two. Has the WTO had a positive effect on the Chinese auto industry, and if so, and more importantly, how has it? In addition, the question of the times concerning the auto industry; can the Chinese compete abroad? Can they follow the example followed by the Japanese and the Koreans and become real global players and if so how long should the world wait for the fourth big one?

## **Key words**

*China; automotive industry; WTO; global potential*

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# CHAPTER 1: INTRODUCTORY NOTES

## 1.1 Introduction

In the past, the Big Three in the automotive industry referred to the three biggest American companies, Ford, General Motors and Chrysler. These companies were by far the biggest in the world and dominated the industry and the global market. After the Japanese “invasion” in the field in the 1960s and 70s, the German industry’s reincarnation after the World War II and the effects of this new era of globalization the term now refers to the three biggest automobile industries of the USA, Germany and Japan. However, it seems that we are entering a new period that the Big Three will actually become the “Big Four”, since China is emerging as a key player in the field with huge potential abilities and a domestic market that at least size wise can be bigger than the “Big Three” combined.

Ever since the reforms started in 1978 the Chinese economy has been growing with very impressive rates. It has become one of the biggest economies in the world and it seems that it is only a matter of time to converge with the more advanced economies of the Western world as well as Japan. Many researchers and scholars believe that by 2030 the Chinese economy will be as big as the American one. A very interesting industry that is particularly important for the country’s growth is the Automotive Industry. With very big levels of production of vehicles and huge potential due to the size of the Chinese market, as well as the potential in going global, is an industry that is expected by many to take the lead in the world market in the not very distant future, possibly much sooner than many would expect just a few years ago. However, it is still at a stage that poses no threat to the Western and Japanese car manufacturers, since it is still lagging behind in innovation abilities and quality, as well as after market services. The question that now many

researchers have is not whether, but when, Chinese automotive manufacturers will be able to follow the Japanese and Korean examples and become global players, competitive in a global environment and whether the evolution of the Chinese automotive industry can be helpful in estimating whether there is something in common with the Japanese one a few decades ago.

A very controversial subject dealing with the Chinese automotive industry was the country's accession to the World Trade Organization. After a process that lasted for almost two decades the country was finally admitted in the World Trade Organization (WTO) in September of 2001. After the accession, China was deprived of its most important tools that it had been using to protect the domestic industries, including the automobile one, before entering the WTO. The government was no longer allowed to use the protectionism measures that it used in the past in order to protect and promote its auto industry, such as high tariffs, performance requirements and numerical quotas. Many experts believed that WTO accession would cause serious problems to the automotive industry since the opening of the economy would cause a flood of imports that would prove to be harmful for the industry, since economies of scale that the Western manufacturers have been enjoying and the lower level of tariffs would allow them to provide better quality vehicles in very competitive prices. On the other hand others believed that the WTO accession would have a positive impact since it would rationalize the industry and attract more foreign investments.

In the first part of the paper, a presentation of the historical evolution of the Chinese automotive industry will be given, so that we have a good idea of how it evolved, how back in the history it goes and get the background knowledge needed. The second part focuses on the WTO accession period, focusing on the few years of negotiations before 2001 and mainly after the official accession until now. The third part will refer to some Chinese automobile manufacturers who managed to effectively compete with the big

multinationals and their joint ventures and their efforts in exporting vehicles to other markets.

## **1.2 Statement of purpose and research method**

In this paper there will be an effort to estimate whether the WTO accession has had a positive impact on the Chinese automotive industry and try to identify the problems and the challenges the Chinese automotive industry faces in a global and very competitive environment, as well as forecast and estimate the future potential of the industry, especially in turbulent times like the one we are living in.

By using a descriptive analysis and describing the process of the Chinese automobile industry's evolution from the very beginnings of it until now and based on various sources and previous studies an effort is made to answer one of the greatest question in the global automotive industry of our times; can the Chinese follow the Japanese and Korean examples in going global and become competitive towards the Japanese, European and American giants? In addition, could the current crisis the world has been facing become an unexpected ally to them and if so can they take advantage of it?

## **1.3 Previous research**

Much research has been done on the Chinese economy, especially after 1978 when the reforms began. The unsurpassable growth rates, the impressive duration of these rates as well as the very interesting combination of socialism and capitalism has made the economy a very hot research subject. Taking into account the importance of the automotive industry for the country's economy one should expect that there has been a lot of research on the industry as well. Indeed the bibliography is very big on the field,

with many papers, articles and books dedicated to the industry's growth, especially after it was officially characterized as a pillar of the economy in the late 1990's. Harwit (2001) came up with three possible outcomes stating that "little real change would be possible if the WTO rules failed to have an active impact". Apart from Harwit's study, numerous articles had been written in favor or against the oncoming changes but most referring to the economy in general, rather than focusing on the automotive industry specifically such as Lee (2000) – WTO entry and the changing structure of Chinese industry or Brilliant's (2004) research for the US Chamber of Commerce.

However, the vast majority of the papers written on it are mainly speculative on the effects of the WTO accession after 2001, since they were mainly written before or around that time. In addition, the ones written after 2001 had very few years of data and experience to deal with, making it very difficult to have a very clear idea of a longer term effect on the industry, as well as the efforts of the Chinese brands to export cars to the West, a goal that seemed too far fetched 6 or 7 years ago but not so much now. Lee (2003) concluded that the industry would probably benefit much from the ongoing WTO accession since the protectionism of the industry, the root of the problem as he characterizes it, would stop.

Not many academic papers have been written to estimate the WTO effect on the Chinese auto industry though. There are numerous articles written in newspapers and websites dealing with the Chinese automotive industry but not much scientific research and academic papers, especially after 2004. This could be attributed to the fact that many people considered that this would actually be the case, and the facts have taken their side. However, the most interesting thing would be to be able to focus on the process rather than the obvious, to many researchers, fact. One would need a few minutes by looking at the tables to realize the success of the WTO accession. However, the procedure as a whole is something very interesting to look at and try to analyze.

This paper hopes to add a bit more on the research on the field, since the data and resources used are as recent as possible and due to the timing is able to take into account the effects of the current crisis on the industry's expansion plans. Hopefully more research will be done in the next years, especially on the role that the current crisis will have had when it is over, when the results of the crisis will be better understood and more years will have passed after the country's WTO accession. We are still in the middle of the Chinese rise as the "big fourth" and what we can mainly do is to use the historical experience and the data we now have in order to try to understand the dynamics of the current situation in order to be able to speculate about the future with better chances of success. In addition, it seems that the presence or absence of similarities between the Chinese case now and the Japanese and Korean ones in the 1970s and 1960s have not been researched in depth leaving space for more research in the future.

## **2: THE HISTORICAL EVOLUTION OF THE CHINESE AUTOMOTIVE INDUSTRY**

### **2.1 The Pre reform period**

In the past, as mentioned in the introduction, the “Big Three” term referred to the three biggest automotive manufacturing countries, the USA, Germany and Japan. After many years of impressive growth, it seems that the term will change into the “Big Four”, since China has been emerging as a huge market and vehicle producer. In this part there will be an effort to present an overview of the Chinese automotive industry, not just for the sake of the historical presentation as an introduction itself, but more importantly to be able to see how the industry has transformed from its early years and how the Chinese have been able to adjust to changes. As people say “look at the past and you will see your future” thus, trying to analyze the past of the industry, we might be able to make some very important conclusions about its future.

One thing one should never forget is that the reform period did not follow a certain “blue print” but it was mainly a period of constant adjustments and experimentation in almost every field and industry. The automotive industry could not be an exception to that. The history of the industry can be mainly divided in three main periods: the pre reform period, starting from early 1920s until the beginning of the reforms, the period between the beginning of the reforms in 1978 until the WTO accession in 2001 and the post WTO accession, from 2001 until now. Even though the main breakthrough occurred during the reform period, we can say that the pre-reform period, before 1978, was a very interesting period, with some activity in the industry, not comparable to the Western industries of course, but a period that set the foundation for the post reform jump.

It could be said that the history of the Chinese automotive industry starts in the early 1950s. However, there was some activity a few decades earlier, in the beginning of the previous century, as early as the 1920s. With the introduction of the automobile in the 1920s, big Chinese cities such as Shanghai and Tianjin started enjoying the benefits of automobile transportation. In 1927 the first truck was produced by the Shenyang Military Factory.<sup>1</sup> Chinese automobile manufacturing and parts manufacturer factories were established in these areas, mainly for the manufacturing of medium and small sized trucks for government, as well as military use. However, due to the Japan-China war in the 1930s, most of them had to be transferred deep into the mainland, in order to be protected from the effects of the war. After the invasion, the Japanese built plants in these areas mainly for military vehicle manufacturing. When the Japanese left the country after the end of the war, these plants remained in those areas and the Chinese government started using them. Apart from this activity, however, it could be stated that big scale automotive industry did not really exist in China before the mid 1950s, except for a few outdated plants that produced vehicles for government use and some small scale workshops that assembled imported vehicles for government and military purposes.

In the early 1950s the Chinese government realized the importance of the auto industry for the country and decided to establish a national automotive industry and started investing large amounts of money in order to do so, 6.6 billion Yuan.<sup>2</sup> The first big automobile plant, the First Automotive Works (FAW) was established in the Changchun province with the financial and technical help and support of the Soviet Union who wanted the plant in that specific location in the northwest China, rather the East coast which was Beijing's wish. The plant's construction symbolized the beginning of the Chinese industry. In 1956, a small scale production of the named by Mao Zedong himself, Jiefang (liberalization in Chinese) trucks started.<sup>3</sup> In 1958 FAW introduced the

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<sup>1</sup> Lee, C. (1997). *The Chinese Automobile industry: manufacturing system and technological strategy*

<sup>2</sup> Li, G. (2004). *Overview of the Chinese auto industry*

<sup>3</sup> [http://www.chinaculture.org/gb/en\\_aboutchina/2005-04/06/content\\_67722.htm](http://www.chinaculture.org/gb/en_aboutchina/2005-04/06/content_67722.htm)

first passenger car made by a Chinese company, the Hongqi (Red Flag) which was manufactured for high ranking government officials. Very soon other factories producing jeeps, trucks and passenger cars appeared throughout the country. Soon, almost every province had its own plant, something that was very much helped by the regional decentralization of the Great Leap forward and the Cultural Revolution in the 1950s and 1960s respectively. During this period, the Chinese automotive industry faced significant development. The total output of the industry rose from just 61 vehicles in 1955 to 22,500 vehicles in 1960.<sup>4</sup> The numbers seem to be, and indeed are, very small compared to the other industrialized countries; for example just Germany itself had the same year exported 841,169 vehicles.<sup>5</sup> However, one should never forget that in the communistic China of those days, and for some years later as well, passenger cars were considered to be a luxury good and such car ownership was forbidden; this kind of vehicles were not imported for the general public, but only for government officials. Thus, the plant produced mainly light and medium sized trucks and passenger cars that would only be used for government or military purposes, even though it is believed by many researchers that the plants at that time did have the ability and the technology to produce passenger cars comparable to the European and American ones, especially since the other super power of the time, apart from the USA, the Soviet Union, was a close ally of the Chinese.<sup>6</sup>

Over time, other automotive industries were established, such as the Shanghai Automobile Assembly plant in 1958 and the Second Automotive Works, which later changed its name into Dongfeng.<sup>7</sup> A few years later, in the early 1960s, the central government introduced the Second Automotive Corporation (SAC), a vertically organized large plant that would produce middle sized military trucks in an isolated

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<sup>4</sup> Holweg et al. (2005) *The Past, Present and Future of Chinese Automotive Industry: A Value Chain Perspective*

<sup>5</sup> Williams et al. (1994). *Cars*

<sup>6</sup> Harwit, E. (2004). *The Impact of the WTO membership on the Automobile Industry in China*

<sup>7</sup> Qiu. (2005) *China's automotive industry*

mountainous area, following the FAW Soviet type of plant, preparing for a war that was never meant to be between the Soviet Union and the USA.<sup>8</sup> Even though the Chinese government wanted to build the plant in the coastal area, just like the FAW case, the Soviet Union preferred it to be near its borders and since they would provide financial and technical support for its construction it was finally built up in the north. In addition, from the mid 1960s, along with the continuous development of former primary plants such as Shanghai Passenger Car Plant (SPCP), some vehicle plants were established in different areas for local transportation needs; plants like the Beijing Jeep Plant, the first Western “invasion” into China’s developing automobile industry, Tianjin and Shenyang Auto Works and others. As mentioned before, these plants did not produce commercial vehicles. They began to imitate and trial produce vehicles for government purposes, mainly trucks.<sup>9</sup>

## **2.2 The Reform period: 1978-present**

The reform period has been a story of impressive success and growth for China as a whole and consequently the country’s automotive industry in specific. The period has been characterized by a rapid annual average growth of real GDP of almost 10.5 percent.<sup>10</sup> The growth of the industry’s production levels from 4,030 vehicles in 1982 to over 2 million passenger cars, buses and trucks in 2002,<sup>11</sup> the first year after WTO accession and more than 8 million in 2008 is one of the most remarkable success stories in history. The passenger car industry specifically was a minor part of the industry as a whole. As late as in 1985 the passenger car production was just a total of almost 5,200

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<sup>8</sup> Chen, J. (1998) *Different Behaviors of Chinese Auto Firms in Technology Introduction and Assimilation*

<sup>9</sup> Committee on the Future of Personal Transport Vehicles in China. (2003). *Personal Cars and China*

<sup>10</sup> Chen, J. (2005) *Assessing China's economic performance since 1978: Material attainments and beyond*

<sup>11</sup> KPMG. (2003). *China automotive and components part market*

cars.<sup>12</sup> Since 1978, when the reform period began, along with the economy as a whole, there has been a very impressive growth and evolution in the automotive industry in the country. Ever since the industry's orientation changed from the previous centralized plan to a more market oriented model, the development of the industry has been huge, turning the country into the biggest vehicle manufacturer in the world.

The opening of the market brought significant changes in the industry. In 1979 the number of the imported passenger cars in China was only 667 cars. By 1980 the imported passenger cars' number skyrocketed to 20,000, putting serious pressure on China's stock of foreign exchange at the time, something that seriously worried the central government. In 1981 the State Planning Commission issued temporary limitations on the production and import of cars but they had a very short term effect on a market that was about to explode. Vehicle imports shot up again resulting to a 20:1 scale of imports and domestic production in 1985.<sup>13</sup> As early as in 1981, the Chinese government, realizing that automobile firms should focus on manufacturing well designed products for companies and individuals rather than standard products for the government, established the China Automotive Industry Company (CAIC) in order to reorganize the industry. The reform aimed at lowering the industry's entry barriers by shifting from central to more local control, stimulating the automobile consumption and encouraged the manufacturing of automobiles in more local areas. Thus the local governments would be able to make decisions about investments at the local level, bureaucracy would be much less intense and the incentives for the local governments would be much more since they had the ability to make decisions. Table 1-1 shows the vehicle imports in China in the 1980s. The extremely high numbers of imported cars from 1984 to 1986 was caused by the infamous Hainan island vehicle binge in 1984 when the island was excluded from the 260 percent import duty imposed to the country in order to spur development. However, the Hainan

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<sup>12</sup> Beijing Institute of Technology Press. (1996). *Automotive Industry of China*, p. 12

<sup>13</sup> Noble et al. (2005). *Executioner or Disciplinarian: WTO Accession and the Chinese Auto Industry*

government took advantage of this preferential policy and flooded the country with Japanese cars. Even after the end of the preferential policy in 1984 the imports were still at very high levels for two more years since there was a big demand for reliable Japanese trucks and taxis, a trend that stopped in 1985 when the government imposed new limitations in the ability of the people to buy imported cars.<sup>14</sup>

Table 0-1: China vehicle imports 1981-1990

<b>China vehicle imports 1981-1990</b>			
	Cars	Trucks	Total
1981	1,401	20,771	41,575
1982	1,101	7,731	16,077
1983	5,806	8,445	25,156
1984	21,651	28,047	88,743
1985	105,775	111,492	353,992
1986	48,276	64,571	150,052
1987	30,536	17,554	67,182
1988	57,433	14,201	99,233
1989	45,001	12,587	85,554
1990	24,063	18,395	65,429

Source: China Automotive Industry Yearbook, 1999

What one should have in mind as far as the evolution of the industry is concerned, should be the fact that the beginning of the reforms and the opening up of the country, there was a sharp increase in tourism, which in cooperation with the constant increase of the average income in the country led to higher demand for taxis, apart from private cars.<sup>15</sup>

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<sup>14</sup> Harwit, E. (1995). *China's automobile industry: policies, problems and prospects*

<sup>15</sup> Harwit, E. (2001) *The Impact of the WTO membership on the Automobile Industry in China*

The growth in inbound tourism has been as exceptional, as the growth of the rest of the economy. In 1978 the total amount of tourists in the country was just a bit more than 1.8 million people, whereas the number in 2000 was more than 80 million.<sup>16</sup> It is worth to mention that local governments have supported the joint ventures by purchasing big numbers of cars for local taxi companies. Shanghai, for example, is famous for the extremely large fleet of the Shanghai Volkswagen Santana taxis.

However, by that time the technological level of the Chinese automotive industry lagged far behind the Western and Japanese ones'. Thus, in order to get access to the technology that Chinese companies did not possess, the Chinese government gave the permission to Chinese firms to start establishing joint ventures with foreign assemblers and part suppliers in order to meet the demand in the market, under the provision that the foreign part's share would not be more than 50 percent, in order to protect the local companies.<sup>17</sup> This was a very good opportunity for foreign companies as well, since they would have the chance to get access to the Chinese market, a market that at that point was quite small, due to the much lower income levels, compared to other countries, but a market that had huge potential, with more than one billion future potential customers. Even though many believe that the most important reason the Western and Japanese car manufacturers entered the Chinese market was cheap labor, most people from the industry would disagree. The costs might be lower in many cases, however not as low as many would believe since there are many non wage expenses that a company should take care of; expenses such as accommodation for the workers and their families, health insurance etc.

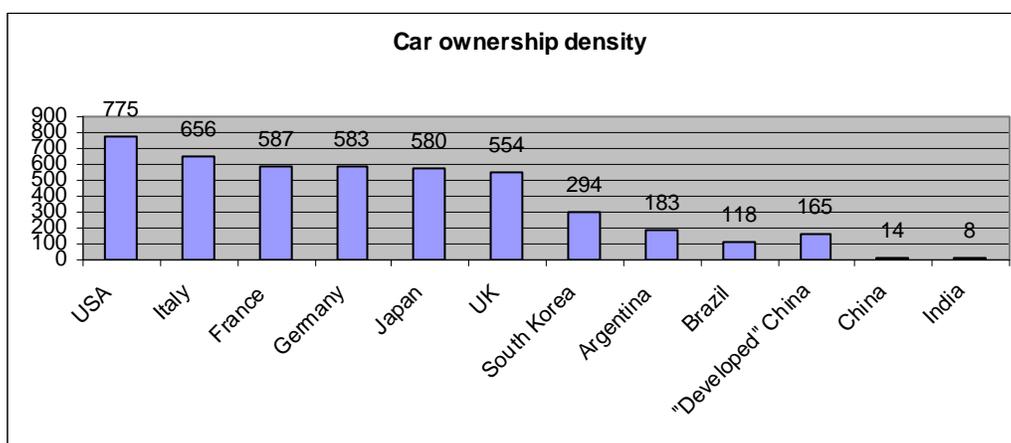
The main reason for the huge interest that companies from the developed countries are interested in China is the potential of the country's market. The continuously increasing income of the Chinese middle class and the population of the country are things one

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<sup>16</sup> Lim, P. (2002) *An econometrics analysis of the inbound tourism in China*

should not ignore. The potential of the market was and still is so big that future sales to a market of more than 1 billion people, was much more important to their eyes. One should never forget that the car ownership density in China, even in our days is much lower than most countries. Table 1-2 provides the automobile ownership density for year 2003 in various countries. We see that 14 cars for every 1,000 people is a very low ratio, compared with European countries or the US something that signifies the huge potential of the market and leaves no questions on why all the multinational automotive manufacturers are trying to get access in the Chinese market. A big share in a future market of 1.4 billion people could mean a massive increase of a company's global sales levels.

Table 0-2: Car ownership in China



Source: BNP Paribas<sup>18</sup>

Note: "Developed China" refers to the big industrialized cities, mainly of the coastal areas

However, most of the early joint venture attempts did not do very well. Due to the strict joint venture limits that the Chinese government had set most of the foreign companies invested mainly orienting towards market access than operational efficiency. As mentioned before, according to the Chinese law a foreign partner could have only up to

<sup>17</sup> Noble et al. (2005). *Executioner or Disciplinarian: WTO Accession and the Chinese Auto Industry*

<sup>18</sup> BNP Paribas, Conjecture. (2005). *Overview of automotive industry in China and South Korea, Market outlook, Risks and Opportunities*

50 percent of the joint venture and assemble only one model, produce one type of part and form a joint venture with up to two Chinese partners. Thus, Japanese companies like Suzuki and Honda, less willing to invest on full scale ventures signed technology licensing agreements with Chinese companies, in order to get the rights to export more to China. The 1986 ban on imports by the government, a reaction to a sharp increase in imported cars the previous year, did not help make the situation better and in addition it damaged the not very strong at that point indeed, Japanese exporters' faith in the Chinese rule of law, thus lowered their incentives to invest in greater scale. As far as the first joint venture in China, the Beijing Jeep which was formed in 1984, it was not very successful due to serious miscommunication problems and conflicting interests, even though the Chinese government tried to support the joint venture as much as it could and make it look actually better than what it really was.<sup>19</sup> The main problem that the Beijing Jeep faced was actually a problem that almost all joint ventures faced, some to a greater and some to a less extent. The Chinese part was mainly interested in getting access to the more advanced technology in order to develop a competitive automotive industry in the future, whereas the Western parts were mainly interested in getting access to the Chinese market. In addition, the lack of rule of law and more importantly the poor intellectual rights protection laws made it more difficult for the Westerners to be willing to share technology; consequently, most vehicles, even in our days, are mainly older models that are kept in production for China.<sup>20</sup> A very typical example of this situation is the known as "the Shanghai model" or as formally known the Volkswagen Santana model, a model that is considered and actually is very outdated in the Western markets and whose production was stopped almost a decade ago in Europe, but which is still being produced in China. According to a survey conducted for Sino-American joint ventures in 2006

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<sup>19</sup> Mann, J. (1989). *Beijing Jeep: The Short, Unhappy Romance of American Business in China*. New York: Simon and Schuster

<sup>20</sup>Gallagher, K. (2006). *China Shifts Gear*

many Chinese consider the American parts to be interested only in selling in China and not developing vehicles there and that they should be more open technologically.<sup>21</sup>

As far as the European manufacturers are concerned, they were very interested in investing in China as well. The first European company to enter the market forming a joint venture was the French Peugeot. Unfortunately, the company had to pull out after suffering heavy losses since it failed to successfully transfer technology to its plant in Guangzhou. However, the French did not give up and in 2005 the PSA Peugeot Citroen Group made a second attempt to form a joint venture with Dongfeng Automobile and in 2006 the company sold 201,300 vehicles.<sup>22</sup> In addition, a second joint venture was formed with the Chinese carmaker Hafei, a carmaker in Shenzhen province, in 2007. According to Clissold (2005), early joint ventures often faced the same problems: the legacies of Stalinist socialism, the lack of rule of law and the very weak management of most Chinese companies which had caused serious problems in the companies' functionality.

However, apart from the unsuccessful attempts by some foreign companies to form successful joint ventures in China there have been some stories of great success. The most significant example is the success of Volkswagen (VW) with the Shanghai Automotive Industry Corporation (SAIC) in Shanghai and recently with the First Auto Works in Changchun.<sup>23</sup> The joint venture between VW and the SAIC was formed in 1985, formulating a plant that had the capacity of productivity of 300,000 vehicles per year. Having the full support of the Shanghai municipal government, which did all it could do to help by purchasing many vehicles for taxis and municipal purposes and by providing supportive regulations as well as a tax privilege system, the joint venture was very successful and reached passenger cars sales market share of almost 50 percent of the

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<sup>21</sup> Gallagher, K. (2006). *International Technology Transfer in China's Auto Sector*

<sup>22</sup> Clissold, T. (2005). *Mr. China: A Memoir*. New York: Harper Business

<sup>23</sup> China daily, *VW opens new joint venture with FAW*, 12/08/2004

Chinese market in 2000.<sup>24</sup> Even though the company's sales have now fallen to much lower numbers after the successful entrance of other major global players in the Chinese market, such as the American GM, as well as the growth of Chinese companies like Geely and Cherry, it still remains number one company in China with a capacity of almost 2 million vehicles annually. In addition, smaller companies like Geely and Cherry are considered by many the only Chinese car manufacturers that have a realistic potential of reaching the production limit of 250 thousand vehicles, a production that is considered to be the limit that leads to economies of scale<sup>25</sup> and compete with the Western and Japanese ones in the short term future.

In 1986, the seventh five year plan was the first that referred to the vehicle industry as a "pillar" industry,<sup>26</sup> meaning a factor of growth for the whole country's economy, stating clearly that it was very important for the country's economic development. The same year, the Chinese government tried to consolidate the industry's production in the three companies that dominated the market at that point, the First Auto Works (FAW), the Shanghai SAIC and the Second Auto Works, or Dongfeng. The two first were to produce medium size cars and the latter would be oriented towards small vehicles. Resistance from localities however did not let the government's plans work as the government wished, so the plan was expanded into a "three big, three small" plan in order to include other joint ventures of Beijing Jeep, Guangzhou Peugeot and Tianjin Xiali (Daihatsu). In addition, the military which had been aiming at the production of civilian vehicles, signed agreements with the Japanese companies Suzuki, Fuji and Isuzu and resisted the industry's consolidation as well. All the above resulted in the failure of the government's plan.

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<sup>24</sup> Committee on the Future of Personal Transport Vehicles in China. (2003). *Personal Cars and China*

<sup>25</sup> Husan. (1997). *The continuing importance of economies of scale in the automotive industry*

<sup>26</sup> Lui, H. (2007). *Does government intervention help the Chinese automobile industry? A comparison with the Chinese computer industry*

In 1994, the Chinese government after 3 years of impressive vehicle production growth (1994 production was almost three times bigger than 1991) introduced the first specific policy document.<sup>27</sup> The “Automobile Industry Policy” was announced in July 1994 and had 13 chapters and 61 policies. The result of the new policy was an even more intense interest on behalf of foreign auto assemblers and part suppliers to enter the market, especially before the WTO accession in order to establish a strong position in the Chinese market before the WTO accession which was about to happen in a few years’ time. The same year, General Motors (GM) signed a contract with SAIC in Shanghai and became the second foreign company to form a joint venture with SAIC after Volkswagen. GM made an investment of 1.6 billion dollars to produce modern and more technologically advanced models, such as the Buick Regal and the Century models, and in addition to help SAIC built a research and development (RnD) center in Shanghai. In return, the Shanghai municipal authorities helped GM construct the plant in less than two years gave the company the freedom it needed to grow fast, freedom much greater than the one VW had enjoyed a few years before.<sup>28</sup> The determination of both sides to make a successful joint venture in Shanghai led to the first produced car in mid December, after a record time of building up a whole factory in just 18 months.<sup>29</sup> Facing GM’s competition, VW invested in the development of new models and put pressure on the local government for the same preferential treatment GM was enjoying. In the province of Guangzhou, Honda replaced Peugeot at the local joint venture with Dongfeng when Peugeot decided to withdraw from its first joint venture after the serious losses it had been facing. In the same time, Toyota formed a new joint venture in Tianjin, a big industrial city northeast of Beijing, increased its stake in Daihatsu and formed various joint ventures with local parts manufacturers and proved the company’s long term commitment to the Chinese market.<sup>30</sup>

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<sup>27</sup>Lee, et al. (2005). *The Impact of Globalization on the Chinese Automobile Industry: Policy Assessments and Typology of Strategies*

<sup>28</sup> Business Week. 17/6/1997; Times Asia. 22/5/2000

<sup>29</sup> The New York Times, *The China drive*, 22/5/2000

<sup>30</sup> Thun, E. (2006). *Changing Lanes in China: Foreign Direct Investment, Local Governments, and Auto Sector Development*. Cambridge: Cambridge University Press

The following table briefly summarizes the developments and the characteristics of each period, in the Chinese automotive industry from the early 1950s until early 2000s.<sup>31</sup>

Table 0-3: Historical periods of the industry

Period	Characteristics
1953-65: Self reliance policy	<p>Roughly 60,000 vehicles produced per year. Relied on Soviet technologies.</p> <p>No other international contacts.</p> <p>Provincial governments set up production units. By 1960, 16 auto producers and 28 assembly companies.</p>
1966-80: Security oriented	<p>Government invested heavily in western regions.</p> <p>Remote locations caused problems and overcapacity.</p> <p>Focus on military vehicles.</p> <p>Rapid increase in car demand and capacity of 160,000 units per year.</p> <p>58 car makers, 192 assembly companies and 2,000 spare parts producers.</p>
1981-98: Initial fruits of open-door policy	<p>Number of companies almost doubled during 83-85 to 114 units.</p> <p>By 1998 almost 2,500 production units. Provisional governments further regionalized production.</p> <p>Major international firms investing.</p>

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<sup>31</sup> Francois, S. (2004). *Regulated efficiency, WTO accession and the Motor Vehicle Sector in China*, The World Bank

	Joint ventures account for almost 60% of production.
1999-present: opening up and beyond	Major investments by foreign companies. All major Japanese and German companies in China. Capacity of more than 8 million units in 2008.

The second part of the paper will focus on the post WTO accession period until now, meaning mainly 2001 up to the present. There will be an effort to describe the WTO accession period, the concerns that were raised by many the years before 2001 and the development the industry has sustained for the past 8 years.

## **CHAPTER 3: THE WTO ERA**

### **3.1 The WTO accession period**

The talks on the Chinese accession to the World Trade Organization took a very long time. After almost fifteen years of negotiations, China entered the WTO in September of 2001. One of the main reasons of this very long period was the lack of an advanced legal system in the country. Significantly important was the lack of bankruptcy law. The socialist heritage did not allow for bankruptcies in the past, since the State would bail out any problematic and loss making state companies; that was the so called “soft budget” constraint. So, in order to gain time to develop a more advanced legal system and bankruptcy law, the Chinese government delayed the accession for a few years.

As far as the automotive industry is concerned, as mentioned in the introduction of this paper, there were many who feared that the WTO accession would mean serious problems for the industry. The fears were actually logical; lower tariffs combined with the economies of scale that global automotive manufacturers enjoyed (meaning cheaper vehicles) would lead to a flooding of cheap and better quality vehicles from abroad, which in combination with better marketing abilities and more popular and respected brand names would cause serious problems to the domestic Chinese automotive industry. It would make sense to expect that people would choose to buy an imported Toyota, than a locally manufactured car for example, both for quality as well as prestige reasons. However, others believed that the WTO accession would actually prove to be good for the industry, since it would rationalize it and attract even more foreign investments. As it was said by a researcher “the Chinese would have to swim or drown”. Looking at the evolution of the industry since 2001, the answer to who was actually right and who was not is quite obvious. However, it would be quite helpful and important to see what kind

of concerns there were the years before China's accession to the WTO, since there were quite a few people, scholars as well as government officials who were very worried about the WTO's accession side-effects on the country in general, as well as the automotive industry more specifically. One should never forget that the automotive industry was and still is considered a pillar for the whole economy and a very important industry, something that was clearly stated in the tenth and eleventh five year plans.<sup>32</sup>

### 3.1.1 The concerns

After the economic growth that the country faced after the opening of the economy in 1978 and the transition from a state planned economy to a market oriented one the WTO accession was considered by many as very important for the country's continuation of economic growth. The trade to GDP ratio had increased from almost 10 percent to 40 percent and inflows of foreign investment (FDI) had surpassed 40 billion dollars in 2000.<sup>33</sup> In order to sustain these very high growth rates, the Chinese government pursued the WTO accession. It could be stated that the Chinese government's motivation for joining the WTO was the fact that the economy needed an external force to overcome domestic obstacles and rationalize in many sectors, as well as protect its trade interests in order to sustain the economic growth it had been facing in 1980s and 1990s.

As far as the automotive industry is concerned, as mentioned in the introduction of this paper, there were many who feared that WTO accession would mean serious problems for the industry. Some party leaders feared that opening to the world would cause significant employment loses in the farming countryside as well as workers' places in the rural areas due to the inability of the local industries to compete with imported foreign

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<sup>32</sup> China Daily. *Auto industry overview*. <http://bizchina.chinadaily.com.cn/guide/industry/industry2.htm>

<sup>33</sup> Adhikari, Yang. (2002). *What will WTO membership mean for China and its trading partners?*. IMF

products.<sup>34</sup> According to the WTO accession opponents lower tariffs combined with the economies of scale that global automotive manufacturers enjoyed (meaning cheaper vehicles) would lead to a flooding of cheap and better quality vehicles from abroad, which in combination with better marketing abilities and more popular and respected brand names would cause serious problems to the Chinese automotive industry. Many feared that foreign companies with little production in China, such as Daimler Chrysler, Ford, Nissan and others would choose aggressive strategies in importing their vehicles to the Chinese market instead of investing heavier in the country which in combination with the eagerness that the Chinese people had for foreign cars before the WTO accession would pose a great threat to the industry.<sup>35</sup> A very important thing one should have in mind is the fact that Chinese leaders were very interested in employment, since employment keeps social stability. That is why the 8 percent annual economic growth is considered to be significantly important for the Chinese government, since it is the level that keeps employment at levels that are considered to be “safe” from causing social unrest. In simpler words, the state would not want millions of unemployed, frustrated people, especially when there is a lack of an advanced social welfare system that could provide a “safety net” for them. More specifically, as far as the automotive industry was concerned, the State Council had expressed serious fears about the consequences of the WTO “side-effects” on the industry,<sup>36</sup> warning about serious employment losses, up to half a million jobs in the industry.

Another concern that many shared was the uncertainty that many local Chinese automobile manufacturers would face in the post WTO era. The number of vehicle manufacturers had risen from just 20 in the 1960s to 60 in the 1970s and almost 125 in the early 1990s, most of which were local inefficient manufacturers with low production

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<sup>34</sup> Harwit, E. (2001). *The Impact of the WTO membership on the Automobile Industry in China*

<sup>35</sup> Harwit, E. (2001). *The Impact of WTO Membership on the Automobile Industry in China*

<sup>36</sup> Lardy, N. (2002) *Integrating China into the Global Economy*, Washington, D.C.: Brookings Institution Press

volumes and low quality standards. The situation in the parts industry was and still is much worse with huge numbers of low quality inefficient companies in the market. These manufacturers were very unlikely to prove competitive without state support against the expected post WTO accession imports.<sup>37</sup> <sup>38</sup> Of course, not only some Chinese were worried about the outcome of the country's upcoming accession to the WTO. On the other side of the WTO agreement, many of the countries that were already members of the organization feared that the heritage of a planned economy and the lack of rule of law would not constrain the behavior of the Chinese firms towards mainly intellectual property issues and the government's support on some domestic companies and maintain the problems that the Chinese economy had been facing.

On the other hand, proponents of the WTO accession believed that the accession would actually prove to be good for the country and the automotive industry in specific, since it would rationalize it and attract even more foreign investments.<sup>39</sup> Poorly performing factories would have to reorganize and lower their costs, as well as improve their quality, in order to be competitive in a much more competitive market something that applied in the parts manufacturer sector as well. In addition, Chinese products would gain easier access to the world markets and the Chinese government would have new legal avenues to appeal if there were any unfair restrictions on Chinese products in foreign markets. The Chinese would have to swim or drown indeed.

WTO accession was a very important step for the Chinese government. It would not just be a very good opportunity to keep rationalizing the country's economy and facilitate trade with the rest of the world. Apart from that there were other, very important gains for china as well. The WTO, in contrast to other bilateral agreements or some open arrangements such as the Asia Pacific Economic Cooperation (APEC) provides lures,

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<sup>37</sup> Harwit, E. (1995). *China's automobile industry: Policies, Problems and Prospects*

<sup>38</sup> People Daily. *Impact on Chinese sectors after WTO entry*. 16/9/2001

<sup>39</sup> Beijing Evening News. 18/11/1999

monitoring and enforcement of the agreements, in a way that is considered legitimate and acceptable by its members.<sup>40</sup> In the case of China, this would mean the end of the annual debates in the American Congress on the renewal of China's most favoured nation status. In addition, WTO accession would mean less arbitrary action against Chinese exported products in various markets of the world. Considering the fact that the Chinese economy was and still is heavily oriented to exports, this can be considered as a very important factor. On the other hand, as said before, China's trade partners hoped to gain better access to the huge and continuously growing market of the country. The WTO accession would reduce the uncertainty about the country's institutions and rule of law, thus make investments in the country safer, something that would lead to increased investments, since companies from abroad would not risk that much. As was mentioned in the first part of this paper, one of the main reasons that the Japanese big automotive manufacturers entered the Chinese market late was the fact that they did not trust Chinese institutions and feared that the lack of rule of law in China would cause serious problems in their investments in the future. The increase of the foreign investments in the post WTO era is quite significant, something that will be dealt with in more detail in later parts of this paper.

Feensta et al (2001) conducted a study in order to estimate the impact that the WTO accession would have on the Chinese automotive industry. According to their research there were three possible scenarios. The first scenario, which was the negative one, basically shared the opponents' of the WTO accession fears: the WTO membership would have a negative impact on the industry, since the domestic industry would be swamped by imported products and become a minor player. According to the scenario, companies with small production in China would rather become aggressive importers of cheaper and better quality vehicles. The second scenario was that of a positive impact on the industry, with the industry able to rise to the challenge of the WTO membership. Big

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<sup>40</sup> Ravenhill, J. (1999). *APEC and the WTO: Which Way Forward for Trade Liberalization?*.

players would remain loyal to the market and improve their products, and start targeting towards low end economic cars aiming at the Chinese middle class. According to this scenario, China would eventually absorb foreign technology and become a new world class automobile producer, like South Korea did in the 1990s. The third scenario, which was the most probable one, was between the previous two ones.<sup>41</sup> According to this scenario, the WTO rules would not have a serious impact on the Chinese industry since China would keep the protectionist policy it had been using throughout its reform period, at the provincial level this time however, since the WTO rules would ban some of its policy measures, such as tariffs and quotas.

### 3.1.2 Entering the WTO/China's commitments

China's commitments to the WTO were very deep. The commitments that were relevant to the automotive industry banned, or at least made difficult to use, some of the most important policy tools that the government had been using all these years in order to protect the industry. Under the WTO commitments China would have to liberalise the automotive market with respect to such fields as tariffs, non-tariffs, investments and trade in services. The new requirements included the following:<sup>42</sup>

- *Gradual elimination of quotas and licenses* concerning the imported consumer vehicles and vehicle parts, starting gradually from 2001, until the final elimination

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*Contemporary Southeast Asia* 21

<sup>41</sup> Feensta et al. (1999). *From import substitution to WTO accession: Government intervention in the Chinese automotive market*

<sup>42</sup> United States of America. International Trade Administration. December/2001.

<http://www.mac.doc.gov/China/Docs/industryfactsheets/autos.html>

in 2005. The initial quota on imported automobiles in automobiles in 2002 was 6 billion US dollars but by the end of 2005 all import quotas had to be eliminated.<sup>43</sup>

- *Tariff cuts.* In 2001 the tariffs o passenger cars were 70 percent for cars with engine capacity lower than 3 litres and 80 percent for the ones with engines bigger than that. According to the agreement, the 2006 tariff levels had to lower to 25 percent. In addition, vehicle components and parts tariffs had to drop to 9.5 percent by 2006, from the levels of 15 to 50 percent in 2001.<sup>44</sup>
- *Opening of various service sectors* such as banking, insurance and non-banking auto financing, import-export of automobiles and distribution services, leasing, as well as wholesale and retail trade.
- *Elimination of certain requirements on foreign investors*, such as local content requirements, export performance requirements and foreign exchange requirements
- *Amendments lifting certain restrictions* concerning what types of vehicles or models would be permitted for production.
- *A higher limit of investments* that would be allowed to be approved at the provincial level; gradually from 30 million dollars in 2001 to reach 150 million dollars in 2005. In addition the removal of the 50 percent foreign equity limit on joint ventures.
- Respect for patents, trademarks and other *intellectual property rights* (IP rights).

Even though China was deprived of most of its most important economic policy tools, it kept the right to the limit of 50 percent ownership in joint ventures in the industry, which still applies, even though there have been voices against it's usefulness for the benefit of the Chinese industry since it is believed by many scholars and researchers that this limitation is a limitation of the industry's growth as well and that it should be

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<sup>43</sup> China daily. *Auto industry overview and the WTO commitments.*  
<http://bizchina.chinadaily.com.cn/guide/industry/industry2-03.htm>

<sup>44</sup> KPMG. (2003). *China automotive and component part market*

abolished.<sup>45</sup> In addition, even after 2006, five years after accession, the country's tariffs on consumer vehicles and parts were higher than many other countries. For example South Korea's auto tariffs are now at the level of 8 percent, significantly lower than the 15 to 25 percent that the Chinese industry enjoys.<sup>46</sup>

After the Tiananmen square incident in 1989 and a couple of years of political instability that had a negative effect on the country's economy as well, the Chinese automotive industry faced significant growth and vehicle production tripled in the years from 1991 to 1993. The following years until the WTO accession in 2001 were years of modest growth. Even though it took only 3 years (1991-1993) for the production to triple in the early 1990s, the industry needed almost seven years for the production to triple again in 2000.<sup>47</sup> However, after WTO accession, it did so again only after 2 years, surpassing for the first time the limit of 2 million vehicles.<sup>48</sup> The following table provides the numbers of cars manufactured during the reform period from 1978 to 2001. As will be described in the next paragraph the growth in the post WTO vehicle production has been much more intense.

Table 0-1: Vehicle production 1960-2001

Vehicle Production	
Passenger cars	
1960	98
1970	196
1980	5,148

<sup>45</sup> Haddock, K. (2008). *China's auto policy, structured for success?*, Autofocusasia.com [http://www.autofocusasia.com/management/china\\_auto\\_policy.htm](http://www.autofocusasia.com/management/china_auto_policy.htm)

<sup>46</sup> Odyssey, B. *Korean, Malaysian Auto Barriers Pose Trade Negotiation Challenge*, www.america.gov 02/05/2006

<sup>47</sup> Feng et al. (2008). *Developmentalism in Globalization: The Transformation of Chinese Automotive Industry since late 1990s*

<sup>48</sup> Noble et al. (2005). *Executioner or Disciplinarian: WTO Accession and the Chinese Auto Industry*

1992	161,745
1993	229,745
1994	247,631
1995	329,728
1996	388,192
1997	481,611
1998	465,139
1999	570,001
2000	604,677
2001	717,791

Source: Holweg et al. (2005) *The Past, Present and Future of Chinese Automotive Industry: A Value Chain Perspective*, 2005/ Car production in the People's Republic of China, statistics pages, 2002

### 3.2 The impact of WTO accession in the industry

Looking at the evolution of the industry since 2001, the answer to whether the fears of the opponents of the WTO accession were right or not is quite obvious. After almost 8 years after China's WTO accession we can now make an assessment on the impact on the Chinese automotive industry. The data that we have now show that the growth of the industry has been even more impressive, in contrast to the pessimistic forecasts that had been expressed in the pre-WTO period. The sedan production for example has increased dramatically since 2001. It is worth to mention that in 2003 the USA car production compared the Chinese one was three times bigger, whereas in 2008 the Chinese managed to overcome the US for the first time in history by almost seven percent.<sup>49</sup> More specifically, the passenger car production in 2000 was almost 605,000 vehicles<sup>50</sup> whereas

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<sup>49</sup> www.eetasia.com. *China outperforms U.S. in 2008 auto production*. 02/4/2009

<sup>50</sup> Global Car Production. (2002). <http://www.geocities.com/fbessem/carprod.html#country>

the country's production for the same kind of vehicles in 2008 was roughly 9.3 million vehicles. Even though the Chinese car quality lags behind in comparison to the European, American and Japanese ones, many believe that it seems that it is only a matter of a few years for the Chinese to reach the "Big Three" quality levels.<sup>51</sup> Table 2-2 provides the vehicle production data after the WTO accession.

Table 0-2: Vehicle production 2001-2008

Vehicle production	
2001	2.341.700
2002	3.251.000
2003	4.443.900
2004	5.091.100
2005	5.704.900
2006	7.278.900
2007	8.890.000
2008	9.300.000

Source: China Statistical Yearbooks, National Bureau of Statistics of China

Another positive impact of China's WTO accession on the industry is the continuous improvements in the technology and quality of the vehicles in the market. Wang (2001) pointed that when investors are located behind tariffs barriers they are not very willing to transfer technology to the market since they do not face serious competition, since the outdated technology they have already introduced is sufficient for a non competitive market. A typical example of this state in Chinese auto market is the VW Santana model, a 1970s model that is still in production in China, even though outdated, with very few changes. However, when these manufacturers face increased competition, something that the WTO accession has brought to China, the technology transfer becomes faster and

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<sup>51</sup> Businessweek.com . *Here Come Chinese Cars*. 26/5/2005

more efficient. To continue with our VW Santana model example, VW officials have announced that the model will be of production in 2012, since the improvements in the technology and quality of the vehicles in the market have lately made it look outdated in the eyes of the Chinese consumers and more modern models, such as the Bora one, will take its place.<sup>52</sup> The increased competition has dramatically increased the options the consumers have, apart from the quality and the lower prices that they have been enjoying lately. More specifically, in 2000 the Chinese consumers had to choose from just eight models in the passenger car market, whereas in 2003 there were 63 available ones<sup>53</sup> and only 3 years later, in 2006 that was the number of the introductions just for the first half of the year.<sup>54</sup>

If one would like to summarize the main characteristics of the post WTO era three things would be of great importance: first of all the gradual rise of the Chinese vehicle manufacturers, such as Geely and Chery. Chinese manufacturers took advantage of the niches in the low end car market, a market that the foreign joint ventures had been ignoring for some time, and produced affordable cars for the Chinese market. Having established a strong presence in the market now, many of them are gradually aiming at the higher quality and priced models. Even though the cars with a foreign brand name are still the majority there has been a constant decrease of the market share that TCNs have been enjoying. TNCs are currently producing two thirds<sup>55</sup> of the vehicles in the market, a share much lower than the almost 90 percent that they enjoyed in the beginning of the century when the country was admitted to the WTO.<sup>56</sup> It seems that the WTO accession proponent's arguments were actually quite valid and that the accession did not damage the local vehicle manufacturers. On the contrary, many of them were forced to reorganize

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<sup>52</sup> Autonews.gasgoo.com. 18/05/2009. <http://autonews.gasgoo.com/auto-news/1010507/Shanghai-Volkswagen-may-stop-making-Santana.html>.

<sup>53</sup> Murphy, D. (2003). *Cost of part keeps China out of export game*. Far Eastern Economic Review

<sup>54</sup> KPMG. (2006). *China's passenger car market advisory*

<sup>55</sup> Feng et al. (2006). *Developmentalism in Globalization: The Transformation of Chinese Automotive Industry since late 1990s*

<sup>56</sup> GL Group. *The Path to Globalization of China's Automotive Industry*. 18/5/2009. www.glgroup.com

and become more competitive in order to survive and with the help from local governments in some cases managed to improve their position in the market and increase their market shares. This trend is very likely to continue since the biggest Chinese manufacturers such as SAIC and FAW have been thinking of transferring from car production in their joint ventures with western manufacturers to making their own models and brands. A second characteristic of the post WTO accession era is the significant reduction in the manufacturers' profitability.<sup>57</sup> Even though this decade has been characterized by a very impressive growth in the volume of the sales, the prices have been reducing due to the increased competition and economies of scale and the profitability has been falling. Still however, the market is growing with impressive rates and is considered to be one of the "hottest" markets in the world, since the continuous improvements in the income levels of the Chinese middle class provides huge potential for the future decades.

In addition, and contrary to what many feared, the gradual reduction of import tariffs matured rather than jeopardized the economy. Instead of creating a flood of imports, it led to the more intense domestic competition with all the positive consequences mentioned above. From 2001 to 2006 the number of imported autos in China increased from 70 thousand to almost 170 thousand. However, since the growth of the market was much greater this resulted in a smaller market share for the imported autos, rather than the opposite. More specifically, for the same period, the market share of imported cars fell from 6 to 3 percent. The loss of the protective tariffs privilege actually made the domestic automakers cooperate more actively with their foreign counterparts and improve manufacturing and RnD capabilities, something that led to lower prices. During the first five years after the country's WTO accession, from 2001 to 2006, the industry experienced an average annual sales growth of 25 percent and an 8 percent annual price

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<sup>57</sup> Chen, Z. et al. (2005). *China's WTO accession impacts on domestic automobile industry. a rudimental approach from the view of scale economy*

fall, because of the increased competition.<sup>58</sup> In addition, apart from the improvements as far as the quality and price level are concerned, the number of the models that were offered to the Chinese people increased dramatically.

### 3.3 The next step

China's automotive industry is still facing some problems that could cause obstacles for its future sustainable growth. These problems are mainly the industry's overcapacity<sup>59</sup> and the relatively underdeveloped auto part industries and services as well as the very big number of the vehicle manufacturers in the country. China has more than 120 vehicle manufacturers, many of which are ineffective. Even though there has been some improvement in the auto part industry there is still much to be done and improved. It is positive that global players such as VW and GM have been willing to assist the local suppliers in improving their efficiency. In addition, as far as the auto finance sector is concerned, high capital requirements are a barrier to entry in this sector and results in less benefits for the consumers.<sup>60</sup>

As mentioned before, a major problem that the Chinese automotive industry has been facing is the very big number of vehicle manufacturers. Since it is considered a pillar for the country's economy, all provinces have been trying to develop their local automotive industries. However, most of them are small, outdated plants with very low production capacity and productivity. Among the almost 120 vehicle manufacturers in China, the top 20 of them possess 90 percent of the market share. Consequently, the rest have very low production. What is more, even among the top 20, most are far from achieving

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<sup>58</sup> www.fadaweb.com. (2007). *What has WTO membership brought to China's auto industry?*

<sup>59</sup> autonews.gasgoo.com. *Many Chinese automakers facing overcapacity*. 2/12/2008

<sup>60</sup> US chamber of commerce. (2004). *China's WTO implementation*

production volumes big enough to reach economies of scale and become competitive in the long term. The Chinese government, in their efforts to solve this problem, is currently working on a plan to create global players that will be able to compete with the current ones like GM, Volkswagen and Toyota. This rationalization of the industry will take some time however, since there will definitely be resistance. However, this is an important step to make since there are very few vehicle manufacturers that actually do have this potential and with some mergers and acquisitions and cooperation with other manufacturers there could be the potential of really competitive global brands in the future.

## CHAPTER 4: THE CHINESE GLOBAL AUTO RUN

### 4.1 The Chinese companies

After September 2001 and the WTO accession one of the main changes that have occurred in the Chinese automobile industry is the challenged dominance of foreign cars in the market due to the consistent rise of the so called national cars. Since the beginning of the reforms, cars have been mainly manufactured by multinational companies in China in cooperation with local manufacturers; the joint ventures. As can be seen from the table 6, the beginning of this century signified a significant increase in production capabilities and growth of Chinese vehicle manufacturers such as Geely and Chery.<sup>61</sup>

Table 0-1: Geely/Chery production

Production levels		
	Geely	Chery
2002	50	50
2003	80	90
2004	106	86
2005	150	188
2006	207	307
2007	219	381
2008		356

Source: various sources/compiled by the author

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<sup>61</sup> Feng et al. (2008). *Developmentalism in Globalization: The Transformation of Chinese Automotive Industry since late 1990s*

In addition, the Chinese partners in joint ventures with foreign companies, such as the FAW and the SAIC, are gradually beginning to transfer from manufacturing foreign cars in their joint ventures towards creating their own brands and vehicles, something that was apparent in the recent Shanghai automotive show held in 20<sup>th</sup> to 28<sup>th</sup> of April 2009 in Shanghai. It is no surprise that quite as recently as 2005, both largest Chinese vehicle manufacturers, SAIC and FAW, announced their plans for national cars, even though it is not likely that they become competitive with their own cars very soon.<sup>62</sup> The opportunities that lie ahead for these Chinese companies are huge, taken into consideration that it is estimated that by 2020, 40 percent of the global sales and more than half of total production (55 percent) will be produced in Asia.<sup>63</sup>

In this part of the paper, we will mainly deal with the potential that the Chinese vehicle manufacturers have to become global players and export big amounts of cars abroad, especially the purely domestic companies, such as Geely, Chery and Brilliance Automotive. These companies provide a very interesting case to study, since they have evolved into serious players in a market in which the competition is extremely intense, with global big players and less government support and protection than in the past, due to the WTO regulations. In addition, they have had to compete against joint ventures with global players many times their size, more experienced in the market and which have been enjoying the protection of local governments, such as the Volkswagen and General Motors joint ventures in Shanghai mentioned in the first part of this paper, as well as the promotion of the central government as well.

Despite all the difficulties that these companies have been facing they have managed to evolve as top ten automobile manufacturers<sup>64</sup> in China and even more surprisingly export pioneers. All three of them have already started exporting to Asian countries, as well as

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<sup>62</sup> Chinese Economic Daily. *Large auto groups make efforts in building self-reliance brands*. 16/5/2006

<sup>63</sup> The Economist intelligence unit. (2006). *Foresight 2020, economic industry and corporate trends*

<sup>64</sup> See table 3-1 for details

other markets outside Asia, such as Eastern Europe and Middle East and have announced plans of introducing their models to the most competitive and demanding countries of Europe and North America. Their success in those markets will be the most important goal for the next few years to come, since success in those markets will give them the feature they mostly miss and what they are after by aiming west: a strong brand name. However, their approaches towards exports are not the same. Some have taken a more cautious and slow strategy and have been targeting the developing countries' markets leaving Europe and North America for the future while others have approached the mature markets of the developed world in a more aggressive way, either by introducing their models in the markets or by mergers and acquisitions of western companies. The recent effort of Geely to buy the very strong Swedish brand SAAB from GM, even though it seems that it will not happen, is a proof that they are serious about it.

#### 4.1.1 The current situation

The Chinese automotive industry was mainly developed with the help of foreign companies which formed joint ventures with the largest Chinese automakers, such as Shanghai Automotive Industry Corporation (SAIC), the First Auto Works (FAW) and Dongfeng Motors. The current structure of the joint ventures in the industry is described in the following table.

Table 0-2: Joint Ventures between Western and Chinese Automotive Firms

<b>Joint Ventures between Western and Chinese Automotive Firms</b>	
BMW	Brilliance
Daimler Chrysler	Beijing Jeep
Ford	Chang'an

Ford	Jiangling
General Motors	SAIC – Wulung
General Motors	SAIC
General Motors	Dongyue
Honda	Guangzhou
Honda	Dongfeng
Honda	China Motors
Hyundai	Beijing
Hyundai	Dongfeng
Mitsubishi	Hunan
Nissan	Dongfeng
Nissan	Zhengzhou
PSA (Peugeot-Citroen)	Dongfeng
Suzuki	Chongqing
Toyota	Tianjin
Toyota	Sichuan
VW	FAW
VW	SAIC

We see that foreign automakers have been cooperating with domestic ones through joint ventures that have been enjoying the support of the central and local governments. However, the industry has been witnessing the constant growth of other, smaller automakers such as Chery and Geely, which have much less or in some cases no support

from the authorities, apart from some local government help in some cases. These companies have taken the opportunity to expand abroad since the bigger and more powerful joint ventures have not been trying to export hard since the automotive industry in China is dominated by joint ventures whose foreign partners are not very likely to support exports in competition with their own products in other markets.<sup>65</sup>

There are more than a hundred vehicle manufacturers in China, something that probably is the biggest problem the industry is facing and only few of them seem to have serious potential to become serious international players in the global automobile market; companies such as Geely, Chery, SAIC and Brilliance. Most of the other firms are too small to reach economies of scale and seriously lack technical and managerial skills. However some of these companies are constantly growing. We see that even though Volkswagen had almost half of the market share in 2000 and the rest would have to share the other half, it now only holds almost 15% with many other companies surpassing the 5 percent levels (table 3-3). However, the production numbers are on the increase due to the market's growth.

Table 0-3: Vehicle producers' market share in 2005

Market share 2005	
Company	Market share %
VW	14
GM	11
Honda	9
Hyundai	8
FAW	7

<sup>65</sup> Cooney, S. (2006). *China's impact on the US automotive industry*

Chery	6
Nissan	5
PSA	5
Geely	5
Mazda	4
Suzuki	4
Toyota	4
Others	17

#### **4.1.2 Export potential and challenges**

It is easy to estimate that eventually Chinese vehicle manufacturers will be able to compete internationally and export vehicles to the more mature and demanding markets of the West and Japan. However, it is not as easy to estimate the time it will happen. Thus, the crucial question to be answered is when and under what circumstances will the Chinese be ready to export big numbers of vehicles. It is clear that they are now not in the position to become significantly big, in a global sense, since they lack quality, safety, technological and managerial skills and their brands are not strong enough to survive the competition that they will have to face when they start exporting their vehicles to mature markets such as Europe and the US.

Apart from their individual disadvantages there are other problems concerning the Chinese automotive industry as a whole, such as the overcapacity of the industry, the huge number of manufacturers and despite what most people think the high costs that the industry is facing. One should not forget that in China the companies provide housing,

health and educational services for the workers and their families,<sup>66</sup> something that in combination with the fact that many key components have to be imported due to the lower quality of the ones manufactured in China creates additional costs that would have to be reduced in order to become competitive in exporting vehicles.

Something vitally important for the industry is to rationalize so that the companies become bigger and more competitive and lower their costs through economies of scale. The number of the vehicle manufacturers in the country is almost 120 and very few of them actually have production of over 100 thousand vehicles in order to sustain efficient production and provide them with the potential of becoming serious players in the market. However, due to the help they receive from local governments this situation does not seem to be changing, maintaining a serious problem that the industry has been facing. The Chinese central government has been trying to promote a rationalization policy in order to create the so called “Big Three”, as it tried to do in the mid 1990s without success,<sup>67</sup> SAIC, Dongfeng and FAW and lower the number of the big vehicle manufacturers in the country from 14 to 10.<sup>68</sup> However, the plan has been hampered by the local governments’ unwillingness to let go of smaller, inefficient manufacturers in order to save jobs and gain political power. Many local banks are helping the local vehicle manufacturers to find finance and local governments are supporting them in their quest to form alliances with global manufacturers, something that causes problems since in many cases they seriously lack understanding of the industry. Indeed, some rationalization has already happened through some acquisitions of smaller manufacturers by the bigger ones, such as SAIC purchase of Chery’s 25 percent or the acquisition of

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<sup>66</sup> Thun E, (2006). *Changing Lanes in China: Foreign Direct Investment, Local Governments and Auto Sector Development*. CUP. Cambridge

<sup>67</sup> As mentioned in Part II of the paper

<sup>68</sup> China.org.cn. *SAIC and FAW may be prompted to buy rival*. 26/2/2009.  
[http://china.org.cn/business/2009-02/26/content\\_17337705.htm](http://china.org.cn/business/2009-02/26/content_17337705.htm)

Nanjing's automotive assets, but this seems to be mainly driven by the individual firms' activity rather than efficient central government planning.<sup>69</sup>

A very serious problem that has to be addressed if the Chinese cars are to be exported in the West is the safety issues the Chinese cars are facing. The Chinese safety levels are significantly lower than the ones provided by the Western and Japanese companies and even though there have been improvements in that field they are still behind. The Brilliance BS6 and the Jiangling Motors Landwind model ASAC crash test failures<sup>70</sup> have created a negative momentum, not just for the companies' reputation, but for Chinese cars in general and have showed that even a respectable Chinese company like Brilliance still needed a lot of work to reach acceptable Western safety standards. Even though there have been improvements in this field, Chinese vehicle manufacturers still lag behind the Western and Japanese ones. In addition, another problem that should be solved is the emission levels of the Chinese cars, which are currently in most cases much higher than the acceptable ones. For example in 2006 Geely announced that even though the company exhibited models at the Detroit Motor Show, the company's cars' emissions were much higher than the regulations and would need further development to reach the acceptable levels.<sup>71</sup>

In order to quicken the process of acquiring technical and design skills, improve the RnD capabilities and improve the overall quality there are four alternative routes to be followed:<sup>72</sup>

1. Acquiring foreign firms or their technologies
2. Entering into partnerships with foreign firms

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<sup>69</sup> The New York Times. *China turns to forced mergers in its auto industry*. 24/2/2009

<http://dealbook.blogs.nytimes.com/2009/02/24/china-turns-to-forced-mergers-in-its-auto-industry/>

<sup>70</sup> Pictures can be found at: <http://landwind.bootnetworks.com/>

<sup>71</sup> Autoblog.com. *Geely makes history at Detroit Auto show*. 10/1/2006

<sup>72</sup> Donnelly, T. (2008). *The Chinese Car Industry and Globalization*

3. Obtaining the services of foreign firms
4. Working with international 0.5 or tier-one suppliers

The world has already seen mergers and acquisitions that Chinese companies are involved and it seems very likely for this trend to continue, since it is a quick way to gain access to technologies, skills and networks that the Chinese companies are currently lacking. The Nanjing acquisition of the British MG Rover, where former engineers of the British company are working in order to improve the company's facilities and models in China, the co-operations of Geely and Chery with European and Australian companies as well as the co-operation of Brilliance with the German giant BMW are typical examples of what has been going on lately. Chery has purchased high quality equipment for its RnD facilities and SAIC has formed a joint venture with Ricardo engineering, a UK design and engineering company and in addition has access to a very advanced development center due to the joint venture with Volkswagen. In addition, Nanjing Automotive plans to spend 250 million dollars on a five year plan in order to kick start RnD.<sup>73</sup>

However, the Chinese companies are still lagging behind in RnD capabilities and it is of vital importance for them to gain this ability. Nanjing's plan on RnD for example might be a serious amount of money but it still is a small amount compared to the other companies' investments. In order to have a better understanding of how seriously the Western companies are taking research is their investments in that field. In 2007 Volkswagen announced that it planned to invest 14 billion Euros within the next 3 years on new products and plants devoted to the VW brand.<sup>74</sup> Of course the sizes are not comparable but this is a sign that even bigger RnD investments should be made in the

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<sup>73</sup> The Economist Intelligence Unit. (2006) *Driven: Are China's Manufacturers Ready to Compete in the US and Europe?*

<sup>74</sup> Edmunds.com. *VW Detail Massive Investment in Future Vehicles*. 27/10/2007  
<http://www.edmunds.com/insideline/do/News/articleId=123736>

future if the Chinese companies really want to become pioneers. The co-operations with these Western and more advanced companies will expose the Chinese to skills they do not possess and create a leapfrogging effect but still there needs to be a plan for a more national policy in favour of RnD and bigger investments on behalf of the companies themselves in order to become true pioneers in the industry. Reverse engineering is after a point no longer effective and different strategies need to be followed.

#### **4.2 Motivations and expanding efforts**

The WTO accession helped the Chinese companies expand and start exporting to the rest of the world. Having reached a sufficient level of quality and safety standards that allowed them to export to developing countries at first, the Chinese companies have already been exporting serious numbers of vehicles. The growth of exports is very impressive, even though it is of course at a beginner's stage. From 1980 to 1998 China exported almost 127,000 cars, whereas nearly 173,000 were exported in 2005.<sup>75</sup> Even more impressively the country reached 680,700 vehicles in 2008 and it is a matter of very few years, maybe even months, to reach one million.<sup>76</sup>

In the Chinese market the domestic manufacturers are facing extreme competition by the larger joint ventures and the imported global manufacturers' cars. The difficulties in competing with big international companies in terms of reliability, safety and emissions, as well as the opportunities in other developing markets where demand is constantly increasing due to the price advantages that they are enjoying have lead domestic manufacturers in exporting vehicles abroad. The vast majority of exported Chinese

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<sup>75</sup> China.org.cn. *Review of China's car industry in past 5 year*. 11/12/2006.  
<http://www.china.org.cn/english/BAT/191884.htm>

<sup>76</sup> China Daily. *China auto export slows in 2008 amid falling demand*. 2/4/2009.  
[http://www.chinadaily.com.cn/bizchina/2009-02/04/content\\_7446068.htm](http://www.chinadaily.com.cn/bizchina/2009-02/04/content_7446068.htm)

vehicles is exported to developing countries where low priced and small cars are more popular and where they can capitalize on their price advantages; countries such as Russia, Vietnam, areas such as Eastern Europe and the Middle East. In addition, the high competition in the domestic market, in combination with the increasing demand for cheap vehicles in the developing markets have been very important factors of Chinese efforts to expand in these markets where it is easier to export cars due to regulations and safety and emission standards.<sup>77</sup>

However, as said before, the key markets that the Chinese companies are aiming at are the mature markets of North America and Europe. It is of vital importance for these companies to build their brand image and that is something that will happen if they are able to export to the West. It is a top priority for Chinese manufacturers to climb up the ladder and enter mature markets and become true international brands from just another Chinese vehicle manufacturer. It is very important for their image to sell cars in many countries, and especially to European and American markets, something that will allow them to be more competitive in the domestic Chinese market as well since they will no longer be treated as cheap car manufacturers but as true global players. In addition, being able to export to these markets will be a proof that these brands will have moved up the next level as well as a practical result of their ability to build good and technologically advanced cars, since the stricter regulations in the Western markets leave no other choice. Being able to meet the much stricter requirements, rules and regulations and passing the quality, safety and environmental tests will show the world that they have achieved much higher standards and that they have reached their international competitors' quality levels.

However, the steps they are making are cautious, especially after Brilliance, the only Chinese company that has so far established presence in the European market, failed to

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<sup>77</sup> Seekingalpha.com. *Chinese companies go abroad*. 5/1/2009. <http://seekingalpha.com/article/113207->

get more than just one star at the Euro NCAP safety tests.<sup>78</sup> Even though the company came back with a better, improved version of the same model just a few months later and got 3 stars, the video that was uploaded on YouTube damaged the brand's prestige, even before it started selling cars to the European market. Consequently, the Chinese manufacturers are taking very cautious steps in expanding to these markets. The means on this expansion are partnerships with certain companies, in order to use their better knowledge on some fields as well as their market channels and in some cases Mergers and Acquisitions (MA), such as the MG acquisition by Nanjing Auto Group, taking advantage of their financial capabilities and the current economic crisis. Access to the partners' factories is very important for them since they get access to more advanced facilities and know how and in addition it gives them the ability to provide competitive after sales support to their customers, a very important factor considered by buyers everywhere.

Chery has already constructed eight factories abroad,<sup>79</sup> all in developing countries such as Russia, Ukraine, Iran, Thailand and Uruguay and has been building cars for these areas giving the company the ability to be closer to the local markets and provide better after sales support, something crucially important for the success of the company's export plans for further expansion into the American and European markets.

Chery is the biggest Chinese vehicle exporter, reaching auto exports of 135 thousand cars in 2008.<sup>80</sup> The company was established in 1997 in the Chinese province Anhui and now has the capacity of 650 thousand cars and engines and 400 thousand sets of transmissions, employing 25 thousand people and having a very big RnD department, for

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[chinese-companies-go-abroad-part-1-the-auto-sector](#)

<sup>78</sup> Video url: <http://www.youtube.com/watch?v=nzoRdDssL1w>

<sup>79</sup> <http://www.cheryinternational.com/>

<sup>80</sup> Autonews.gasgoo.com. *Chery still leads China auto exporters in 2008*. 13/7/2009,

<http://autonews.gasgoo.com/auto-news/1011074/Chery-still-leads-China-auto-exporters-in-2008.html>

Chinese standards.<sup>81</sup> The main motto of the company's export plans is "first developing countries, then the developed ones". So far the company has been exporting to more than 70 developing countries, virtually everywhere in the world apart from North America and Western Europe, taking advantage of the less strict emission and safety standards, as well as the importance of the price factor in these markets. However, the main target, and the one that will be able to boost the company's sales and level is of course the developed and mature markets of the developed world.

Mergers and acquisitions are ways that the Chinese are using in order to gain access to these markets taking advantage of their good financial condition, the cash they have and the strong support of the government concerning exports.<sup>82</sup> Chery for example has recently got a 1.5 billion dollar loan from China Exim for the company's overseas expansion plans and the rumours for the company's acquisition of currently facing bankruptcy GM-owned Volvo are getting more and more intense the time this paper is being written. There are serious doubts about the company's ability to acquire such a big brand as Volvo since it is a very big brand, much bigger than itself and it seems quite unlikely for the Chinese company to acquire a brand that its value is estimated to more than 5 billion dollars.<sup>83</sup> In addition, there is serious doubt on whether the Chinese would have the managerial and marketing abilities to control and make use of such a big brand. Nonetheless, the interest that Chinese companies have been expressing lately in acquiring western companies, even though sometimes it seems that they are too big for them to handle, is a proof of how serious they are about it and that they have money to spend in a period that everyone is trying to cut costs and sell assets.

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<sup>81</sup> <http://www.cheryinternational.com/>

<sup>82</sup> Huliq news. *External Internal MnAs to Fuel China's Auto Industry*. 21/11/2008.  
<http://www.huliq.com/3169/73305/external-internal-m-fuel-chinas-auto-industry>

<sup>83</sup> Autonews.gasgoo.com. *Chery auto gets green light to buy Volvo car brand*. 6/3/2009

Forming alliances with western companies is another typical practise for Chinese companies since it provides access to advanced facilities and knowledge. A very important goal for these companies is the improvement of managerial and technical skills, as well as their design abilities which are considered almost equally important to quality, especially in mature markets. Qi Yumin, the chairman of Brilliance Automotive himself has stated that the most important goal of Brilliance is to improve the company's design and brand management capabilities.<sup>84</sup> Geely, the second largest domestic automaker in China and an export pioneer, has acquired an Italian Design brand in order to improve the company cars' designs and an RnD center in Japan to improve the company's technological capabilities and in addition it has been cooperating with Mitsubishi in their efforts in creating competitive engines for the company's models.<sup>85</sup> What is more, the company has founded colleges in Beijing, Zhejiang, and Hainan where thousands of students study each year gradually forming a tank of talented, young engineers that will eventually work for the automotive industry. Geely is actually the only automaker that has not had any kind of help from the government so far, something that according to Mr. Li Shufu, the company's chairman, has been the most important factor of the company's competitiveness since many of the companies that enjoyed state help had far less incentives to become productive and competitive. Geely's main advantage is the low costs that it faces during production, mainly due to the low average age of its employees, meaning much lower salaries and health benefits, as well as its location to the north-east part of China, where the costs are much lower than the ones the international companies face in Shanghai or Beijing. In 2007, the company formed a joint venture with a British company to manufacture the famous London taxis in Shanghai and Chery has been cooperating with Daimler Chrysler in making cars for the American market.<sup>86</sup>

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<sup>84</sup> China Daily. *Qi shares opinion on China's auto industry*. 13/10/2008

<sup>85</sup> <http://www.geely.com/>

<sup>86</sup> Bradsher, K. *Too many Chinese cars, too few Chinese buyers. So far*. The New York Times. 18/11/2006. <http://www.nytimes.com/2006/11/18/business/worldbusiness/18auto.html?pagewanted=1&ei=5088&en=2b01e1df7842c15&ex=1321506000&partne>

On the other hand it is very interesting to see Brilliance's efforts since Brilliance is the only Chinese automaker which has already introduced its models in Europe apart from Russia, South Africa and the Middle East countries. The company from Shengyang province has been producing minivans and luxury passenger cars. In order to improve quality and technical skills Brilliance signed a cooperation contract with German luxury car company BMW in 2003 and since then they have been producing BMW series 3 and 5 for the Chinese market at the company's factory in China. Under a technical assistance agreement with BMW the German company has been providing engineering consulting services to the Chinese technicians.<sup>87</sup> The company aims at selling 300 thousand cars in China<sup>88</sup> and 10 thousand cars in the European market in 2010. It is very important for these companies to form an advanced network of dealers, in order to be able to promote their vehicles and provide after sales services to its customers and a very important ally is the company's European distributor, Austrian HSO Motor Europe, which has as general manager Mr. Hans-Ulrich Sachs, the man who imported very successfully Hyundai cars in Europe 20 years ago.<sup>89</sup> In addition the company is cooperating with the Japanese Toyota and Mitsubishi in its efforts to improve the models' engines and with the Italian design company Italdesign S.P.A., since it is very important to sell cars that have high levels of design.<sup>90</sup>

However, even if the Chinese companies manage to get access to the technology and experience they are missing right now the main problem will still exist: the entrance in a market that the buyers are very demanding and not particularly willing to buy something unknown and where brand reorganization, emissions and quality and safety are very important, even more important than price itself. In order to gain significant market share,

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<sup>87</sup> <http://www.brillianceauto.com/main.html>

<sup>88</sup> www.theautochannel.com. *Brilliance auto aims to sell 300,000 vehicles in '09*. 31/12/2008

<sup>89</sup> Beijing Times. *Brilliance motors to have big success in Europe*. 3/4/2009

<sup>90</sup> China Daily. *Qi shares opinion of China's auto industry*. 13/10/008

the Chinese automakers have been planning in following a similar strategy to the one that they have followed in the domestic market against the joint ventures and the Japanese and western imports. They will have to use their cost advantages and introduce cheap cars in the markets, without cutting down on quality and safety however, since mature markets are much more demanding than developing ones. In addition, the Chinese government has been pushing companies like Geely, Chery and Brilliance Automotive in order to create global brands that will be able to compete in the global environment, following the steps of other brands in different industries, such as Lenovo in the computers industry. The example of the Japanese and Korean brands in the 1960s and 1970s is something the Chinese are aware of and it seems that even though the times are very different there are quite a few similarities in these cases. Surprisingly, it seems that the current financial crisis is actually an ally rather than a problem for the Chinese companies.

#### **4.3 Global crisis: an ally or an enemy?**

The current financial crisis has caused serious problems to the global automotive industry. All the global players have been facing problems and trying to cut costs, or sell brands and assets that are not very profitable, or loss making. Very recently the GM said that it was approached by a Chinese company to buy German brand OPEL<sup>91</sup> and Swedish brand SAAB is currently on sale by General Motors in its efforts to find a solution to the serious financial problems it has been facing lately. It is generally believed by most economists and organisations that the world economy will start recovering in 2010, thus it should be reasonable to expect another year of very low growth rates. Unfortunately for the automotive industry it is one of the sectors that are hit harder by the crisis.

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<sup>91</sup> China Daily. 7/7/2009. [http://www.chinadaily.com.cn/china/2009-07/08/content\\_8397225.htm](http://www.chinadaily.com.cn/china/2009-07/08/content_8397225.htm)

The crisis has unavoidably affected the Chinese economy as well, lowering the growth rates at record low levels, something that has consequently had an impact on the local automobile industry. However, even though the times are difficult the Chinese, taking advantage the better financial condition they have in comparison to their American and European competitors, are trying to expand. Nanjing Automotive, a relatively small automaker bought the English MG Rover in 2005 after bidding against Shanghai's SAIC as a first step of the company's long term European plans. For the time being the company is producing the Row'ee models for the Chinese market based on the Rover 25 and 75 models but the main objective of acquiring more advanced facilities, technology and technical skills a sales network base in Europe was fulfilled.<sup>92</sup> In addition, SAIC owns 51 percent of South Korean SUV manufacturer Ssangyong since 2004 when it bought its share for almost 500 million dollars. However, these acquisitions do not always become profitable. SAIC has been facing serious problems with managing Ssangyong<sup>93</sup> and there are doubts whether acquiring brands and factories is good enough on its own. Chinese companies are reported to have tried to acquire Swedish SAAB and Volvo, as well as German Opel from GM and they are on the look for opportunities to buy brands and assets in order to accelerate their export plans. Mergers and acquisitions are a good way to jump start and move faster but the Chinese companies need to improve their RnD and research capabilities if they want to be truly global leaders. It seems that many of them are taking it seriously and are gradually increasing their RnD expenditure and in addition hiring managers from western companies in order to improve their management and quality control problems.

Even though the times are particularly hard for the global industry, an opportunity seems to be rising for the Chinese companies; an opportunity that the Japanese and especially Toyota and Honda, faced and took advantage of in the 1970s that actually helped them introduce their models into the American market. In order to understand the potential the

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<sup>92</sup> BBC. 23/7/2005. <http://news.bbc.co.uk/2/hi/business/4708739.stm>

Chinese are facing and see similarities in the Chinese path towards the West we should first present a brief history of the Japanese “invasion” in the American market that started taking place in the 1960s and peaked in the mid 1970s.

#### **4.3.1 The Japanese “invasion”**

Toyota’s success in the United States took place in the early 1970s and it was a result of significant cost advantages over their American and European (mainly Volkswagen) competitors, the very intense domestic competition with NISSAN, as well as the two oil crises that the world faced during that decade. Toyota had been working on Toyopet, a small economic car aiming at low and middle class car buyers trying to take advantage of the niche in a market that big cars were dominant, since 1947. In 1957 the company introduced the model in the American market but failed to create a positive image since it performed poorly in the tests in the States and sales were very poor. However, the company did not give up and despite the bad reputation it had among the very demanding and used to driving big cars American customers decided to create a model that would be focused on the American market and overcome the problems it faced in their first effort with Toyopet. In order to overcome the problems they had been facing and get rid of the bad reputation, concerning mainly quality and safety issues Japanese cars had in the US, they hired consultants from American companies who managed to introduce techniques that improved their cars’ quality to a great extent. The result of their RnD efforts created the Corona model, a model that aimed towards people who wanted a cheap, small and fuel efficient car that differentiated from the big, fast cars the public had been offered by the American companies. Toyota managed to take advantage of the market niche that existed in the American market and enjoyed the advantage of being the company that first introduced such cars in the market, even though these cars were not popular at all these days. In addition, the Toyota Production System and the advanced logistics abilities

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<sup>93</sup> Autoparts007.com. 27/3/2009. <http://news.autoparts007.com/en/show/2009327/1356.html>

created the opportunities to reach economies of scale and made the Japanese cars' production cost much cheaper than their American adversaries. The weak Japanese yen at the time played a significantly important role since it made Japanese cars cheaper than the American and German ones, since it was weaker than both dollar and German mark leading many dealers to change to Toyota cars and helped create a network of Toyota dealers, something very important for the company's introduction to the market. Just like the Chinese case the Japanese companies were heavily protected by the Japanese government during their first steps, since the state had decided to protect and support 3 main companies that would be leaders in the market. We should not forget that the Chinese government's 11<sup>th</sup> 5 year plan aims at creating 3 big players in the market that will be able to compete in the global environment with the American, European and Japanese manufacturers.

However, on top of all the above, there was a very important coincidence that played a very important role, not so much on whether the Japanese cars would gain access to the market though; this was just a matter of time, as it seems to be the case now with the Chinese cars. The two oil crises of the 1970s helped the Japanese introduce their cars faster than expected since the more oil conscious Japanese companies had already been producing cars that were much more fuel efficient than the American ones and when the crisis struck and gasoline became much more expensive they were able to provide the market with inexpensive quality cars that consumed much less gasoline than the American competition, turning them into leaders in the small car market, a market that was going to be a very big one in the years to come. The American's efforts to provide smaller cars more damaged their image than help them increase their market shares since they did not have the experience and ability, as well as the time, to develop good quality small cars and the end of the second crisis in 1978 found Toyota with a market share of 25% in the American market, mainly to the company's ability to provide good quality, cheap and fuel efficient cars.

The similarities with what the world's industry has been facing recently are quite a few and able to make researchers that the history repeats itself, at least up to a point. Even though the markets and the global situation is not the same we can see that this period resembles the Toyota case 30 years ago in many ways. The current global crisis provides the opportunity for the Chinese manufacturers to emerge as new key players in the global automobile market since they are in a position to provide cheap cars to many markets. Whether they will actually be successful will be determined by their ability to improve safety, quality and environmental standards. Just like the Japanese 30 years ago they have the strong support of their governments with legislation that protects them and low interest government loans, like the cases of BYD or Geely, and in addition the advantage of the exposure to new management and production techniques through the joint ventures most Chinese manufacturers have set with Western and Japanese giants in China. In addition, the extreme competition that the Chinese market provides is a good pull force for them to improve, especially since the WTO accession and the imports of better, cheap Western cars in the domestic market. As mentioned in the second part of the paper, the WTO had a very catalytic role in the evolution of the Chinese companies since it provided all the conditions the market needed to become truly competitive, something that helped the Chinese companies improve. Last but not least the country's, as well as the companies' fortune to have cash in such a serious crisis is a very important factor that one should never forget. The Chinese now have the ability to pursue much more aggressive strategies and instead of trying to create an attractive brand image for the Western markets they can "buy their way in", taking advantage of the financial difficulties many automotive companies are facing all around the world.

However, there are some serious differences between the two cases. First of all there does not seem to be such a big market niche similar to the small car one in the early 1970s. It could be claimed that the environmentally friendly cars are the future of the automotive industry but since the Chinese companies are lagging behind and have not the same RnD capabilities indicates that this is a niche that they will not be able to take advantage of; at

least in the short term future. It is very important for the Chinese companies to improve their RnD capabilities since that is the only way to become true pioneers in the technological sector. In addition, the competition is much harder now that there are many companies that have reached a certain quality level and the markets are now totally different than 30 years ago.

However, the industry will at some point recover from the crisis and they will need to be ready when it does. The competition is very strong in our era, much more extreme than the one the Japanese and Koreans faced some decades ago and in combination with the Chinese government's inability to support the industry as much as the Japanese, Korean and even the Chinese ones did in the past it is of vital importance to improve their RnD capabilities and create a strong and indigenous industry with strong brand names that will be able to compete in this global environment. The mergers and acquisitions that some companies have been using as a tool to gain access to technical and management skills as well as sales and after sales networks is a good way of reducing the time that they would need in order to become more competitive but improving their RnD capabilities and becoming pioneers in technological matters will be the most effective way of forming strong brand names, which is the long term goal and a guarantee that the sales will reach their global competitors' levels after all.

## CHAPTER 5: CONCLUSION

The Chinese automotive industry is a story of rapid growth and huge potential. From the almost non-existent state of the pre reform era to the biggest vehicle manufacturer era in terms of production levels in 2009, only 30 years after the beginning of the reforms is something that could impress everyone. The WTO accession in 2001 managed to create the conditions that would improve the domestic manufacturers, contrary to many people's fears that it would cause serious trouble to the domestic automobile industry. The production capabilities increased tremendously and the domestic market has become a "war field" with cut-throat competition but potential that the world has never seen before. The potential of 50 million cars in the not very distant future is something that cannot be ignored by anyone; especially the global automotive giants from the USA, Europe, and Japan and of course the constantly growing domestic manufacturers. However, a very important step for the Chinese manufacturers is to be able to export abroad, and especially in the developed and mature markets of the Western world. By doing so they will gain the status of truly international brands and will create strong brand names that will allow them to boost their sales, not only abroad but in the domestic market as well.

Following the example of the Japanese and Koreans a few decades earlier they are now trying to enter the European and US markets having the unexpected help of a crisis, just like their Japanese counterparts thirty years ago, which in combination to a booming domestic market and their financial capabilities makes them in a powerful position. The Chinese companies, especially the domestic ones now have an opportunity to make a serious entry in the Western markets and it seems that it is a matter of a few years for them to become big global players. What most people had been expecting to happen seems to be very likely to become reality much sooner than most researchers would actually expect. It is very important for the Chinese to do what the Japanese and Koreans did in the past even though the times and the markets are very different and the strategies

to be followed should be different as well. They should take advantage of the opportunities they are and will be facing in the future in order to improve their brand image, their technological and managerial skills and improve their RnD capabilities to a serious extent. Taken into consideration of the abilities that the Chinese companies have been presenting all these years, the momentum of the economy as a whole and the great support from the central government it seems that it will take them less time to become big in a global scale than their Asian neighbors. Perhaps an estimation of having exports in competitive to the global giants' numbers and competition in the more advanced and mature markets of the US and Europe from Chinese vehicle manufacturers in the next 10 years would not be extremely optimistic; on the contrary. It took the Japanese 30 years to become big in a global sense and it seems that the Chinese will make it much quicker. In order to do that however, there are many things that they will have to improve. The domestic industry will have to rationalize in order to move to the next step, even though this might cause some social problems at first. The time of reverse engineering is coming to an end, now the Chinese manufacturers must start creating on their own and they seem to be on the right track.

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