

Market Leadership in the Chinese Automobile Industry

Strategic Management in a Dynamic Environment –

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Abstract

The People's Republic of China is gaining increasingly in significance as a market and production location for the international automobile industry. Together with the component supply industry; at the same time, the automobile sector represents for the Chinese government one of the most important pillars of economic and technological development in the country. From the point of view of strategic management on the part of international automobile manufacturers, current investments in the Chinese market are an indication of globalisation and keener international competition. One thing is certain: automobile production is no longer tied to traditional locations. High-tech products such as automobiles can in principle be manufactured to the same standard anywhere in the world. The peculiarities of the Chinese market and its specific advantages as a location are indeed challenging the involvement of the international automobile industry. Collaboration between companies, joint development, production and marketing, exchange of components and technology are, as part of international co-operation and decentralised automobile production to ensure a global presence, fundamental factors in strategic management for success. (1). Only by leading in technology based on faster and more efficient realisation of product and process innovation will market leadership be achieved in China.

Uninterrupted economic dynamics

At the beginning of this new century, China is one of the most interesting but also most uncertain markets in Asia. The Chinese economy is growing at a speed and to an extent that Germany and Japan experienced during the “Wirtschaftswunder” years. Economic growth at 7.8% is expected for 2000, following 7.1% in 1999. The investment bankers Merrill Lynch are even forecasting a growth rate of 8.5%. The foundations for this economic development were laid in the second half of the Seventies, with the economic and political reforms and more openness to other countries (2).

The economic dynamic of recent years derives mainly from the investment made by companies financed from outside of China and the increase in exports thus initiated. In addition, the Chinese Government continues to encourage wider public investment and is thus stimulating growth. Imminent membership of the WTO will make development even more dynamic with lasting effects for international automobile producers (3).

China is not a homogeneous economy; commerce and buying power are concentrated mainly in the coastal regions, where most of the international companies have established themselves. The old areas of heavy industry are in the North, a modern centre for technology and services is developing in Shanghai in the East and since the formation of the first special economic areas, the southern

regions are emulating the model of the former British crown colony Hong Kong, now a special administrative region, in their economic development (4).

The income of the population is increasing, particularly where industry is concentrated and a new consumer class with a lot of buying power needs to be supplied with high-quality consumer goods, particularly with modern automobiles. The strategies adopted by the car industry can no longer ignore China as a production base and market. There is not a single company in the sector that can seriously afford to neglect the Chinese market in the long-term, if it does not want to lose its market position in global competition. Market and technology leadership in China are the key to long-term successful penetration of other markets in East and Southeast Asia (5).

Chinese efforts

As well as getting involved with foreign companies, the Chinese are making efforts themselves to prevail in the automobile market. The roots of the Chinese automobile and components industries go back to the Thirties when the government set up a program for the production of commercial vehicles. Between 1938 and 1958, Japanese and Soviet support helped to set up production works for HGVs in the industry and trade centres Shanghai, Tianjin, Changchun and Nanjing (6). The components industry was in those days still very low-key which

meant that Chinese manufacturing and fitting plants were characterised by considerable manufacturing depth.

The first automobiles nationally were produced from 1958 in Changchun with the “Red Flag“ and in Shanghai with the model „Phoenix“. The following decades saw the foundation of more companies in very varied segments of the vehicle industry. Today, car manufacturers in China number around 130. This includes both the big joint ventures with foreign participation and also completely Chinese producers, who often produce fewer than 1,000 vehicles per year. After China joins the WTO, these small business will further reduce in number.

In the course of the opening up, in market economy terms, of the country since the end of the Seventies, contacts with international foreign automobile manufacturers have been made with the aim of modernising production, both economically and technologically. The first joint ventures in the automobile industry were set up in 1982. At the same time, globally active groups negotiated production under licence with Chinese companies.

Volkswagen AG was the first German car manufacturer to enter into a joint venture in China. In 1985, Volkswagen started production of the “Santana” model in Shanghai. In this early phase, manufacturing was carried out in the same factory buildings used for the “Shanghai”, – a model based on the Mercedes Benz 180 which was manually welded and fitted and was a successor to the “Phoenix” model mentioned above (7).

At the end of the Eighties, there were around 5 million vehicles in China, of which 75% were commercial vehicles and only 25% passenger vehicles. The commercial vehicles were mainly locally produced and the proportion of imported passenger cars was particularly high at this point in time. Taking 1985 as an example, China imported 200,000 vehicles from Japan alone. In order to avoid further outflow of foreign exchange, the Chinese government has restricted vehicle imports considerably since 1986 and at the same time has promoted the construction of a modern domestic passenger car production (8).

Of the approximately 130 automobile manufacturers currently in China, around 16 produce passenger vehicles; however only four of these businesses achieve annual output of more than 100,000. These are SAIC (Shanghai Automotive Industry Corporation), FAW (First Automotive Works), DMC (Dongfeng Motor Cooperation) and the Tianjin Automotive Industry Corporation (TAIC). Two manufacturers, the Shanghai Automotive Industry Corporation and the First Automotive Works, where Volkswagen is involved in joint ventures, achieve output of even more than 200,000 vehicles per year (9).

The remaining vehicle manufacturers in China make at best 1,000 vehicles annually. Their products are not competitive, nor is their production technology sufficiently well developed (10). These companies are characterised by inadequate potential for innovation together with poor capitalisation. The situation with the Chinese components industry is not at all better; this is also

characterised by the weaknesses already mentioned. Currently there are around 2,500 producers of components and parts for the automobile industry in China.

Influence of the state

From the point of view of the Chinese economy as a whole, transport infrastructure represents a bottleneck for the development of the automobile industry in China. As regards quantity and quality, the trunk road and motorway systems are particularly in need of development if one disregards some outstanding new infrastructure projects in the industrial centres on the coast. The Chinese state is making great efforts to improve this situation with various infrastructure projects. In 1998, 60 billion dollars were invested in motorway construction.

The government intends to make the automobile industry one of the pillars of the Chinese economy as quickly as possible, in order to accelerate sustained development in other areas. One positive aspect is the expert knowledge of the Chinese leadership. Both Jiang Zemin and Li Lanqing worked in the automobile industry in Changchun in the Fifties and both completed a practical course in the industry in the former UdSSR. Also, from 1985 – 1990 Jiang Zemin, party leader in Shanghai at that time together with the Minister President Zhu Rongji, then mayor of Shanghai, intensively promoted the building up of the joint venture with VW there.

The Chinese government wants to see 90% of the Chinese demand satisfied by vehicles produced in China. The bureaucracy has limited foreign capital investment to a maximum of half the total capital of the joint venture.

However, this regulation does not stop the automobile manufacturers from engaging in joint ventures, as can be seen from the examples of Volkswagen, Citroen, Peugeot and Chrysler. Japanese companies were more restrained in their direct investment in the Eighties and early Nineties than their American and European competitors. Japanese involvement in the market is concentrated in licensed production. Suzuki, Daihatsu and Fuji Heavy Industries took this less risky route. (11) Toyota is only now engaging in this dynamic and difficult market, but much more aggressively and longer term than its Japanese competitors: with direct investment.

Potential for growth in the passenger vehicle segment

The potential in the automobile market is very promising. In 1992, production had already exceeded 1 million vehicles per year and now, with over 1.7 million vehicles produced and sold annually, the Chinese market has grown to an impressive size. China is now the tenth largest vehicle manufacturer in the world. For international manufacturers and the components industry, the Chinese market is particularly interesting on account of the combination of well-developed

market size with further potential for growth in the coming years and the development of a class of brand-conscious consumers.

The use of passenger vehicles has changed crucially in recent years. The proportion of institutional buyers of passenger vehicles including authorities, companies owned by regional bodies (state, province, city etc) and other public bodies such as taxi companies has fallen in comparison with private buyers. Personal demand is booming, not least as a result of higher incomes in the industrialised areas.

Alone in the period from 1991 and 1996 development in the passenger vehicle segment accelerated rapidly, demand for passenger vehicles in this period rising annually by an average of 38 percent. The absolute figures are even more impressive: since the mid-Eighties, passenger vehicle production has risen from 12,300 in 1986 to over 500,000 in 1999.

A closer look at the shares of the production figures between passenger vehicles, HGVs and commercial passenger vehicles in 1991 together with the figures anticipated for 2000 shows the shift towards passenger vehicle production more clearly. Whereas the percentages of the whole for passenger vehicles, HGVs and commercial passenger vehicles in 1991 were still 11.44 percent, 24.83 percent and 63.73 percent respectively, in only six years these figures have altered in favour of passenger vehicle production: passenger vehicle (30.44%), HGV (27.18%) and buses (42.35%). And the expected figures for 2001 go even further: Passenger vehicle production is forecast to be two thirds of automobile

production in China overall. The most important passenger vehicle manufacturers such as Guangzhou Honda, FAW Volkswagen or Tianjin Charade have increased production since the beginning of 1999 (12).

Trend towards compact cars

Since the earlier Nineties, as a result of the increase in income even in small households a clear trend has appeared in China: the popularity of the private compact car. Therefore the efforts of most automobile manufacturers are concentrated on the development of the appropriate models. Shanghai Volkswagen is the only manufacturer which is not making real efforts to develop in this direction, but also has the required competence and resources to manufacture a compact car for the Chinese market in a relatively short period of time completely. In comparison, the Chinese passenger car producers have having problems with the manufacturing technology and also in the quality of their results.

In the mid-Eighties, Chinese manufacturers of compact cars were already giving up production of their own engines. Chinese management is now pursuing a different strategy: importing Japanese technology. The brands Alto, Skylark and Charade are equipped with engines from Suzuki, Fuji and Daihatsu. These are brands, which came to be the leaders in the Chinese market. However, the standard of quality in the vehicles does not yet meet international requirements

and each attempt by the Chinese manufacturers to improve the quality of their product increased the sales price inexorably with a not inconsiderable effect on sales. The introduction and enforcement of higher standards of quality with simultaneous cost control are thus core tasks for the strategic and operative production management in Chinese automobile plants.

Pricing pressure and model changes

However, increasing production numbers are only one side of the coin. Pricing pressure on the individual manufacturers is showing an increase in competition despite increasing demand. Production of the Santana at Volkswagen in Shanghai is also affected. In the first quarter 2000, sales of the Santana model fell by 17.7%. In April 2000 Santana sales fell by 23% compared to April in the previous year to 16,840 vehicles (13). To counter further falls in sales, Shanghai Volkswagen is looking at further price reductions. It is not just a matter of reducing high stock levels, but also of keeping the market share over 40%; the market share currently enjoyed by Volkswagen in China overall is currently 56%. New sales and production strategies are under discussion at Shanghai Volkswagen, to penetrate the expanding market in very different segments.

It is clear that the automobile industry in China overall will achieve lower profit margins if prices continue under pressure. The First Automotive Works group which as well as their own HGV production has entered into various joint

ventures with foreign producers (VW and Ford) is also subject to considerable pressure to reduce costs. Between 1994 and 1998 gross profits have fallen dramatically, from US\$ 143.65 million to 13.3 million. However, an about-turn was achieved with the introduction of a new HGV model in 1999. FAW is a licensee of the Deutz Company and equipped the new HGV series with modern turbo diesel engines. Together with the Volkswagen Group, FAW is currently producing the Jetta, the new Jetta, and various Audi models. More than 100,000 Audi 100 vehicles alone have been sold since 1988. At the beginning of September 1999, the factory in Changcun shipped the first “China version” of the Audi A6 in order to compete successfully in luxury brands with models from DaimlerChrysler and BMW.

With the Passat B5, Shanghai Volkswagen is also launching a new model on the Chinese market. Since mid-2000, the Passat has been in batch production in one of the allegedly most modern factories in the Volkswagen group. Parallel to the traditional models Santana and Santana 2000, the market is being worked with progressive technology. Both on product level and also on manufacturing technology level, Shanghai Volkswagen is setting new standards. The strategic goal is to counter growing competition in the upper middle class segment from foreign manufacturers in China. General Motors, who is also represented in Shanghai with a production works, is concentrating on this market segment. Shanghai Volkswagen will only retain its market position in the long-term with strategically thought out technology based on rapid and continuous realisation of

product and process innovation. The successes of the pioneering strategy have been gradually consumed. Now it is a case of getting to grips with the new technological challenges posed by technological innovation in the automobile sector and starting to introduce them to the market as soon as possible. With advanced technology, which practically has a monopoly on the market, it is possible to maintain a leading position in the market throughout the life cycle of a technology. This can be secured by distribution arrangements and the price. (14). Over the next few years, Shanghai Volkswagen intends to produce two new compact cars. One of these small car models will be oriented towards the familiar Lupo model; further ranging plans however also assume the development of a completely new model.

The Volkswagen group – leading in the market and in technology

The Volkswagen group recognised very early on the long-term market opportunities in China. First discussions regarding Volkswagen's involvement in the People's Republic took place in 1978. In 1982 the basic agreement on building the Santana was signed by Volkswagen and the Shanghai Tractor&Automotive Corporation, which at that time was produced in South America and Europe. Just one year later, the Santana model rolled off the production line. A further important milestone Volkswagen's involvement in China was the signing of a joint venture agreement in October 1984. Besides

Volkswagen (50%), there are three joint venture partners on the Chinese side: the then Shanghai Automotive Industry Corporation (SAIC, 25%), the Bank of China (BOC, 15%) and the China National Automotive Industry Corp. (CNAIC, 10%). The fundamental goals of the joint venture included building the Santana and building up its own engine manufacturing plant. In addition to their capital, the Chinese partners made land, labour, buildings, materials and energy available to the joint venture. Volkswagen for their part committed themselves to designing the manufacturing technology and to passing on the necessary management expertise. In 1985 the joint venture Shanghai Volkswagen Automotive Company Ltd. (SVW) went into business. In 1993, Shanghai Volkswagen produced already more than 100,000 Santanas and an equivalent number of engines in the factory built specially for this purpose. Two years later the production volume rose to 160,000 vehicles, whereby the production volume included 30,000 of the further development Santana 2000.

In 1996 200,000 vehicles came out of production in Shanghai, of which over 80,000 were Santana 2000. In view of the rapid growth, Shanghai Volkswagen expanded its capacity to 300,000 vehicles and 330,000 engines annually. According to the board member Robert Büchelhofer the VW group sold a total of 315,232 vehicles in China in 1999. 5% growth is expected for 2000, sales are estimated at DM 10 billion. The VW group had invested around DM 3 billion in China up to now; there are more than 10,000 employees in Shanghai. Volkswagen is basing its commitment, its growth and expansion strategies on the strategic

concept of technological leadership: up to 2005 VW is investing three more billion DM; the intention is to retain its market share of 50% after China has joined the WTO, when it is assumed that the Chinese automobile market will double in size over the following three to five years (15).

Market and technological leadership is also supported by the VW Group's involvement in Northeast China, in Changchun, to be more precise. Historically, following the successful entry into the market in Shanghai, the next step in the expanding the Chinese market was a licensing agreement between Volkswagen AG and the First Automobile Works (FAW). From 1988, Audis were made in the north Chinese province of Jilin, in the city of Changchun. 1991 saw the establishment of the second joint venture in China. Volkswagen acquired a 40% share in the FAW Volkswagen Automotive Company Ltd. (FAW-VW) in Changchun. Today the VW Jetta, the New Jetta and various Audi models are manufactured here. In September 1999 the first Audi A6 rolled off the production line. VW's strategic technology leadership is apparent in this market segment.

Creative management of technology

For international automobile manufacturers the Chinese automobile market has developed over the last two decades into a promising, but also risky target. Competition for market share is increasing and will intensify in the mid-term after China joins the WTO. Japanese, American and European businesses are involved

with wide ranging direct investment in this dynamic market, not only in order to exploit the growing market potential, but also to share in the local profitability in the long-term. To be on the spot, to be familiar with the market, and the situation, opens up strategic room to play for a successful venture in one of the most important automobile markets in Asia.

European, American and Japanese businesses have all adopted different strategies to open up the market in China, not least because of the ways of realising and implementing strategy. In the practical realisation of market expansion strategy, there are many ways in which an international automobile manufacturer can differentiate. Readiness to adapt, creativity and flexibility and the necessary intercultural skills and managerial sensitivity, taking into consideration the socio-cultural environment and the specific requirements of the regions are fundamental prerequisites for successful implementation of competitive and market strategies in China. However it is crucial to ensure a top market position with technological leadership (16). This incurs extra costs, which are closely associated with opening up the market and finding resources, yet the deciding advantage is the lead over the competition with the associated opportunity to have a meaningful potential technology.

It is necessary to establish a creative technology management strategy for China with Asia/Pacific on the horizon, which starting from the core areas production, product, organization, personnel and distribution covers all the functional areas of the business. With the formulation of a strategy for technological leadership, four

main players must be included in the analysis: the business itself, the customers, the competition and the state. These four elements form a dynamic whole with specific interests, differing motivations and goals. Without taking into consideration state requirements, regional peculiarities and historical structures, the competitiveness of a business in China can be put at risk.

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